



CORPORATE GOVERNANCE IN PAKISTAN: BEYOND A MINIMALIST APPROACH

Samza Fatima

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**CORPORATE GOVERNANCE IN PAKISTAN: BEYOND A
MINIMALIST APPROACH**

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**CORPORATE GOVERNANCE IN PAKISTAN: BEYOND
A MINIMALIST APPROACH**

By

SAMZA FATIMA

**A thesis submitted to the University of Bedfordshire in partial fulfilment of
the requirements for the degree of Doctor of Philosophy**

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“The proper governance of companies will become as crucial to the world economy as the proper governance of countries”

James D. Wolfensohn

President of the World Bank, 1999

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ABSTRACT

The issue of corporate governance (CG) has taken central position in debates after the major financial crisis in almost all parts of the world. Numerous endeavours have been made to improve CG in Pakistan. However, these efforts did not produce the required results. Moreover, the existing literature fails to establish the impact of these efforts and CG norms on the performance of listed companies in Pakistan. Therefore, this study intends to investigate the CG framework of Pakistan, identify its weaknesses and explore opportunities for its improvement. For this purpose, the four variables of CG amongst others have been selected which include: the investigation of Code of Corporate Governance (CCG) of Pakistan (law in books), enforcement mechanisms in relation to the implementation of CG standards (law in action), the role of board of directors (BODs) and the role of institutional investors (IIs) in enhancing the companies' performance and improving the CG practices. This study is conducted by employing a socio-legal research methodology due to its mixed nature of being legal and corporate. A qualitative research method is utilised by employing an inductive approach, interpretative research philosophy and exploratory strategy. The results of this study declare important for regulators to update CCG regularly by assessing its impact on companies' performance and evaluating the attitude of companies towards the full and partial adoption of CCG. This practice will increase compliance with CCG. Moreover, this thesis develops a 'Board Effectiveness Model' in order to make BODs diverse and independent. Furthermore, this thesis explores strategies to enhance the part of IIs in the CG of their investee companies. The researcher believes that the recommendations proposed by this thesis, if implemented, could make considerable improvement in the corporate sector of Pakistan which will enhance investor confidence and will also attract foreign investment.

AUTHOR'S DECLARATION

I declare that this thesis is my own unaided work. It is being submitted for the degree of Doctor of Philosophy at the University of Bedfordshire.

It has not been submitted before for any degree or examination in any other University.

Name of candidate: Samza Fatima

Signature:

Date:

CONFERENCE PAPERS

1. A paper was presented on ‘Enforcement of Corporate Laws in Pakistan’ in a conference organised by International Journal of Arts and Sciences held at Harvard, Boston, USA on 26-30 May 2015.
2. A research Poster was presented on ‘The Activism of Institutional Investors in Promoting Corporate Governance in Pakistan’ in an annual conference of University of Bedfordshire in July 2014.
3. A paper was presented on ‘Research Methodology’ in an annual seminar of Centre for Research in Law (CRIL), University of Bedfordshire in August 2014.

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LIST OF ABBREVIATIONS

ABI	Association of British Insurers
ACCA	Association of Chartered Certified Accountants
ADB	Asian Development Bank
ADR	American Depository Receipt
AEIB	Arab Emirates Investment Bank
AGM	Annual General Meeting
AIM	Alternative Investment Market
AMCs	Asset Management Companies
AMCR	Asset Management Companies Rules
AMR	Asset Management Rules
AOA	Articles of Association
ASIC	Australian Securities and Investment Commission
BE	Board Effectiveness
BM	Board Membership
BP	Board Process
BS	Board Structure
BESOS	Benazir Employees Stock Option Scheme
BODs	Board of Directors
CA	Companies Act
CAMP	Capital Asset Pricing Model
CARD	Consolidated Admissions and Reporting Directives

CCG	Code of Corporate Governance
CCM	Commercial Courts in Malaysia
CDC	Central Depository Company
CEO	Chief Executive Officer
CFO	Chief Financial Officer
CG	Corporate Governance
CIA	Capital Issues Act
CII	Council of Institutional Investors
CIPE	Centre for International Private Enterprise
CJP	Chief Justice of Pakistan
CLA	Corporate Law Authority
CLD	Corporate Law Decisions
CLRC	Corporate Law Review Committee
CO	Companies Ordinance
CS	Company Secretary
CSC	Corporate Strategy Committee
CSRC	Chinese Securities Regulatory Commission
DB	Director Behaviour
DC	Director Competence
DE	Director Effectiveness
DFI	Development Financial Institutions
DI	Director Independence
DTRs	Disclosure and Transparency Rules
ECGI	European Corporate Governance Institute

EEA	European Economic Area
EEC	European Economic Community
EU	European Union
FCA	Financial Conduct Authority
FCC	Financial Court of China
FDI	Foreign Direct Investment
FIs	Financial Institutions
FOEs	Family Owned Enterprises
FPCCI	Federation of Pakistan Chambers of Commerce and Industry
FPI	Foreign Portfolio Investment
FRC	Financial Reporting Council
FSMA	Financial Services Market Act
GDRs	Global Depository Receipts
GOP	Government of Pakistan
HC	High Court
HSC	Human and Social Capital
IA	Internal Audit
IASB	International Accounting Standards Board
IBA	Institute of Business Administration
ICA	Indian Companies Act
ICAP	Institute of Chartered Accountants of Pakistan
ICAR	Investment Companies and Advisors Rules
ICC	International Chamber of Commerce
ICGN	International Corporate Governance Network

ICGP	Institute of Corporate Governance of Pakistan
ICP	Investment Corporation of Pakistan
IFIs	International Financial Institutions
IIs	Institutional Investors
IMF	International Monetary Fund
INEDs	Independent Non-executive Directors
IOSCO	International Organization of Securities Commission
IPO	Initial Public offering
ISC	Institutional Shareholders' Committee
ISE	Islamabad Stock Exchange
JSE	Johannesburg Securities and Exchange
KSE	Karachi Stock Exchange
LLSV	La Porta R, Lopez-ed-Silanes F, Shleifer A and Vishny RW
LSE	Lahore Stock Exchange
LSE	London Stock Exchange
LUMS	Lahore University of Management Sciences
MMA	Maldives Monetary Authority
MMOU	Multilateral Memorandum of Understanding
MOA	Memorandum of Association
MOU	Memorandum of Understanding
NBFC	Non-banking Finance Companies
NEDs	Non-executive Directors
NIT	National Investment Trust
NITL	National Investment Trust Limited

NB	National Bank
NBFIs	Non-bank Financial Institutions
OECD	Organisation for Economic Co-operation and Development
OLS	Ordinary Least Squares
PCOs	Provincial Constitutional Orders
PICG	Pakistan Institute of Corporate Governance
PISR	Principles on Institutional Shareholders Responsibility
PSE	Philippines Stock Exchange
PRM	Prudential Regulations for Modarbas
PSM	Professional Securities Market
REITs	Real Estate Investment Trusts
RIS	Regulatory Information Services
RMAB	Royal Monetary Authority of Bhutan
ROA	Return on Asset
ROE	Return on Equity
ROI	Return on Investment
ROSC	Report on Observance of Standards and Codes
SBP	State Bank of Pakistan
SC	Supreme Court
SEBI	Securities and Exchange Board of India
SECA	Securities and Exchange Commission Act
SECA	Stock Exchange Control Act
SECP	Securities and Exchange Commission of Pakistan
SECSL	Securities and Exchange Commission of Sri Lanka

SEO	Securities and Exchange Ordinance
SEOI	Securities and Exchange Organisation of Iran
SETS	Securities and Exchange Trading System
SFM	Specialist Fund Market
SOX	Sarbanes-Oxley Act
TI	Transparency International
UAE	United Arab Emirates
UN	United Nations
UNEP	United Nations Environmental Programme
USAID	United States Agency for International Development

GLOSSARY

- The Code:** the Code of Corporate Governance of Pakistan
- The CCG:** the Code of Corporate Governance
- The Constitution:** the Constitution of the Islamic Republic of Pakistan, 1973
- The Ordinance:** the Companies Ordinance, 1984
- The SECP Act:** the Securities and Exchange Commission of Pakistan Act, 1997
- Pyramiding:** Pyramiding is taking a control of a firm (subsidiary) through majority shareholding and then taking control of another firm with the combined shareholding and so on to build a large holding company that provides managerial and financial (and sometimes marketing) functions for the entire group.
- Cross share-holding:** Cross-shareholding is in which, minority stakes held by two companies in each other; this is often done to help strengthen long-term business relationship.
- Interlocking management:** A common business practice where a member of company's BODs also serves on another company's BODs or within another company's management.
- Free-rider Problem:** Free-rider problem means that one shareholder bears the cost and has to do efforts; however the benefit is enjoyed by all shareholders.

CHAPTER ONE: INTRODUCTION TO THESIS

1.1 Introduction

This chapter provides the introduction of this thesis. It presents the research background of this study in order to understand the significance of corporate governance (CG) and justify why CG is chosen for this research specifically relating to Pakistan. Furthermore, this chapter defines the research problem for this study and presents the evidence of existence of research problem in the corporate framework of Pakistan. After identifying the research problem, it identifies and explains the aim and objectives of this study followed by research questions. Furthermore, this chapter presents the rationale and significance of each research question and explains how this study will be conducted in order to get the answers of these research questions. Lastly, this chapter provides the structure of this thesis.

1.2 Research Background

CG is expanding and changing constantly,¹ by a desire for transparency, accountability, fairness, disclosure responsibilities and increased investor confidence in the financial markets.² There is no single generally accepted definition of CG,³ as it is not an easy concept to define,⁴ because every country has different structures of CG according to its needs.⁵ Therefore, some authors⁶

¹ Andrew Keay, *The Enlightened Shareholder Value Principle and Corporate Governance* (Routledge 2013) vii

² Bob Tricker, *Corporate Governance, Principles and Practice* (2nd edition, Oxford University Press 2012) “See generally”

³ Jill Solomon, *Corporate Governance and Accountability* (4th edition, Wiley 2013) 5

⁴ Ibid (n 1) 6

⁵ Ibid (n 3) 8

⁶ The names and definitions of these authors are presented below.

attribute broader meanings to CG and define it in broad way however, others attribute narrow meanings to CG.⁷

The term CG has been defined broadly by the Cadbury Report as: ‘a framework through which companies are directed and controlled’;⁸ by Thomas Clark as: ‘CG relates to the exercise of power in corporate entities’⁹; by Monks and Minow as: ‘a relationship among various participants in determining the direction and performance of corporations’¹⁰; and by John Farrar as: ‘the CG involves considering the legitimacy of corporate power, corporate accountability and standards by which the corporation is to be governed’¹¹.

In short, the broader definitions of CG encompass that the CG deals with the structure, processes, cultures and systems that stimulate the successful operation of the corporation.¹²

The OECD, the UK Department of Business, Innovation and Skills, Professor Mulbert and Sir Adrian Cadbury defined CG in narrow way. According to the OECD; the CG structure stipulates the distribution of rights and responsibilities among divergent stakeholders in the corporation. Likewise, it additionally specifies the structure through which the company’s objectives are established and achieved and monitoring performance.¹³

This researcher choose the broader definition of CG for this study which is: CG is the name of a framework within which the companies are managed and monitored. This definition takes the general stance and includes all internal and

⁷ Ibid

⁸ *The Cadbury Committee, Report of the Committee on the Financial Aspects of Corporate Governance* (The Cadbury Report 1992) Para 2.5

⁹ Thomas Clarke, *Theories of Corporate Governance* (Routledge 2004) 1

¹⁰ Robert Monks and Nell Minow, *Corporate Governance* (3rd edition, Blackwell Publishers 2004) 1

¹¹ John Farrar, ‘Corporate Governance, Business Judgement and the Professionalism of Directors’ (1993) 5(1) *Corporate and Business Law Journal* 1

¹² Ibid (n 1) 7

¹³ OECD, *Principles of Governance* (2004)

¹¹ <<http://www.oecd.org/dataoecd/32/18/31557724.pdf>> accessed 12 December 2015

external factors of a corporation which require direction and monitoring, hence more appropriate.

However, CG is different from managing the companies on daily basis, as this is concerned with tasks delegated by board of directors (BODs) to executive management. On the other hand, CG relatively has a more strategic and overarching function: it focuses on steering a company in a direction that could lead towards long-term values and goals.¹⁴

The advantage of effective CG is that it enhances share price.¹⁵ The principles of CG emphasise on the practices of check and balance among the companies' management, accountability, transparency, disclosure requirements and corporate social responsibility. Such practices improve the image of a company and attract investors by signalling them that their investments are in secure hands. Therefore to achieve capital becomes easier.¹⁶ Moreover, foreign investors are usually reluctant to make investments in those companies that do not take after CG standards.¹⁷ This fact shows the importance of CG principles.

CG is a relatively new term, which became popular in 1980s, however the principles of CG were already in practice by which the companies were being managed and controlled.¹⁸ This term is used to describe the phenomenon which has been practiced since the creation of corporate entities.¹⁹ The theoretical application of the subject CG is new however; the practice of the principles of CG is as old as trade. The need of CG principles was there even when in 1932 Berle and Means highlighted the agency issues. Whenever a principal has to rely on

¹⁴ Ibid (n 1) "See generally"

¹⁵ Christine Mallin, *Corporate Governance* (4th edition, Oxford University Press 2013) 1

¹⁶ Ibid

¹⁷ Ibid 1, 2 & 3

¹⁸ Ibid (n 15) 15; ibid (n 2) 4; George Peters and Karibo Bagshaw, 'Corporate Governance Mechanisms and Financial Performance of Listed Firms in Nigeria: A Content Analysis' (2014) 1(2) Global Journal of Contemporary Research in Accounting, Auditing and Business Ethics (GJCRAABE) An Online International Research Journal 103
<www.globalbizresearch.org/files/gjcra_george-t-peters_Karibo-b-bagshaw-75205.pdf> accessed 1st January 2015

¹⁹ Ronald Gilson, 'Corporate Governance and Economic Efficiency: When Do Institutions Matter?' (1996) 74 Washington University Law Quarterly 327

agents for the handling of his business, governance issues arise, and these issues have long been recognised in order to run and regulate modern enterprises.²⁰

1.2.1 Development of Corporate Governance in Pakistan

Before 1997, the entities responsible for regulating and enforcing CG in Pakistan were the Ministry of Finance (MOF), Corporate Law Authority (CLA) and the State Bank of Pakistan (SBP). However, in 1997 CLA was replaced with the launch of Securities and Exchange Commission of Pakistan (SECP), which is now the chief enforcer working under MOF and controlling authority of corporate sector of Pakistan.

The evolution of CG in Pakistan took place in three stages. First stage was during the period of 1999-2002,²¹ which was a structural formation phase. During this period SECP came into existence by replacing CLA and the first Code of Corporate Governance (CCG) was drafted for the listed companies of Pakistan. The drafting of CCG was initiated by Institute of Chartered Accountants in Pakistan (ICAP) and was finalised with the collaboration of many stakeholders including Institute of Cost and Management Accountants of Pakistan (ICMA), academics and listed companies.

The guidance was taken from other countries' CCG for the formulation of CCG for Pakistan; most significantly from the UK and South Africa.²² The guidance was also taken from the Organisation of Economic Cooperation and Development (OECD) Principles of CG. Asian Development Bank (ADP) was providing finance to develop CG in the corporate sector of Pakistan. However, at that time SECP and other partner institutions had to face financial obstacles from their sponsor (ADP). Moreover, during the same period listing regulations were also formulated and it was made a condition that all companies listed on Karachi Stock Exchange (KSE) will have to follow CCG.

²⁰ Ibid (n 2) 4

²¹ With the issuance of CCG. In 1999 the first CCG for Pakistan was drafted which was issued in 2002, known as 'the Code of Corporate Governance 2002'.

²² SECP, 'Manual of Corporate Governance' <<http://www.nzibo.com/IB2/manual-CG.pdf>> accessed 11 February 2015

The second stage was during the period of 2002-2006 and this phase was about creating awareness regarding the benefits of adopting CCG among the business community. For this purpose Pakistan Institute of Corporate Governance (PICG) was established with the collaboration of International Finance Corporation (IFC). Initially CCG required implementation in public sector companies and banks.

Third stage comprised from 2006 to date. This phase requires implementation of CCG in all listed, non-listed, and public companies. Banks also adopted the same CCG with some additional clauses. However, this stage is still incomplete because the CCG is not being adopted and implemented in its entirety.²³

1.2.2 Research Problem and its Evidence

1.2.2.1 The Application and Enforcement of CCG in Pakistan (Weaknesses in ‘Law in Action’)

The background of Pakistan’s CG discussed above reveals that the major problem which lies in Pakistan’s corporate sector is the inappropriate application and implementation of CCG, which shows that the regulators such as PICG and SECP have failed to enforce CG principles in its true spirit and create an awareness among the general public and the business community about the advantages of CCG so far.

The main factor behind this inappropriate compliance with the CG principles is the lack of interest/ignorance of government towards this issue.²⁴ Rather government requires from PICG to formulate a separate code of governance for state-owned enterprises (SOEs) such as Pakistan International Airlines (PIA), Pakistan Telecommunication Company Limited (PTCL), National Bank of Pakistan (NBP) and many more.²⁵ This demand of government is not the only reason of assuming the non-serious role of government. There are a number of

²³ Faryal Salman and Kamran Siddiqui, ‘Corporate Governance in Pakistan: From the Perspective of Securities and Exchange Commission of Pakistan’ (2013) 12(4) The IUP Journal of Corporate Governance 13, 14

²⁴ The opinion of former Commissioner of SECP Mr. Etrat Hussain Rizvi

²⁵ Ibid

examples which elucidate the *mala fide* on the part of government rather than the failure of CG presented below.

For example, PIA and NBP are listed on KSE but the appointment of their BODs does not take place according to company law. Rather, the government appoints its directors according to her will. The principles of CG require a proper plan of succession; however NBP does not have any such plan. One of its presidents was elected four times as a president of NBP. Secondly, the most important position of a public company, the office of CEO of SBP remained vacant for many months.²⁶ This shows the absence of a proper succession plan in such public organisations and clear violation of corporate laws on the part of government functionaries. In addition to these, many scams have also been noticed in insurance companies such as, National Insurance Company Limited (NICL).²⁷ The evidence/examples of CG failures in SOEs are presented in following paragraphs.

Firstly, the NICL was a multi-billion rupee scandal which remained in the news for a long time. It was against the son of former Chief Minister of Punjab Ch. Pervaiz Elahi and some directors of NICL. The scandal was about the deal of some favourite properties facilitated by Moonis Elahi (son of Pervaiz Elahi) during his father's reign. The cost of public money was believed to be around 3.5 billion rupees of which the share of Moonis Elahi was alleged to be 220 billion. The case remained in court for a couple of months, FIA and NAB were involved in the investigation. The investigation was completed and Moonis Elahi charged guilty but no action could be taken beyond this. Neither public money could be recovered nor was Moonis Elahi penalised. He flew abroad. The NICL was not a new or the only case in Pakistan sadly; powerful politicians are accused of

²⁶ Ibid (n 24); Faryal Salman and Kamran Siddiqui, 'Corporate Governance in Pakistan: From the Perspective of Securities and Exchange Commission of Pakistan' (2013) 12(4) The IUP Journal of Corporate Governance 13; 'Corporate Governance in Pakistan: From the Perspective of Pakistan Institute of Corporate Governance' (2013) 12(4) The IUP Journal of Corporate Governance 17

²⁷ Evidence is provided in the following paragraphs.

expropriating public money routinely and set examples for not obeying law and CG principles instead of being active to enforce laws and regulations.²⁸

Secondly, the privatisation of PTCL is another CG failure on the part of government. Since 1990, Pakistan has sold 166 SOEs for 476.5bn rupees to back shot-falls and expand efficiencies of the mismanaged companies to motivate for economic growth.²⁹ It is a common belief that strategic corporations like PTCL ought not to be privatised in light of the fact that outside insight can access secret telephonic communication between Pakistan and other countries which can cause loss to Pakistan in its economic development.

A deal like PTCL has not been honed anyplace else, which incorporates both value and administration control, and the purchasers have not paid the full bid money even after seven years of procedure. It is remained to be proven wrong whether the privatisation bargain has supported new purchasers to the expense of public and national interest.³⁰ The privatisation of PTCL caused a big financial loss and unemployment.³¹

Thirdly, Pakistan Railway (PR) is another example of a big CG failure. Just a couple of decades ago, PR were considered the safest and most economical way of transportation.³² Till 1980, PR accounted for 65 per-cent of Pakistan's freight traffic, which sadly reduced to 15 per-cent by 2009 and now is at 1 per-cent or even less.³³ Corrupt railway management led this corporation to disaster. Top PR management and the government of Pakistan (GOP) are responsible for

²⁸ Few examples are provided in this section; The Dawn News, 'An Article on NICL Scandal Published on 26 January 2011' <<http://www.dawn.com/news/601723/nicl-scandal>> accessed 30 November 2015; The News Tribe, Various Articles Published from January to November 2011 <<http://www.thenewstribes.com/tag/nicl-scandal/>> accessed 30 November 2015; NICL scandal was also published in all newspapers of Pakistan; See also <<http://www.transparency.org.pk/nicl.php>>, <<http://www.nicl.com.pk/>> or <<http://www.fia.gov.pk/en/index.php>>

²⁹ Information is collected from the website of NAB Pakistan, <<http://www.nab.gov.pk/>> accessed 30 November 2015

³⁰ Riaz Mangi and Kamran Siddiqui, 'Privatisation of PTCL: Corporate Governance Failure' (2013) 12(4) The IUP Journal of Corporate Governance 36

³¹ The Daily Times, 31 December 2014 <<http://www.dailytimes.com.pk/national/31-Dec-2014/ptcl-s-privatisation-caused-financial-losses-unemployment>> accessed 20 November 2015

³² Information is collected from the website of PR <www.railpk.com> accessed 30 October 2015

³³ Ibid

appointing inexperienced and ineligible staff beyond the capacity.³⁴ Currently PR is facing around 40 billion rupees deficit and has closed down thirteen passenger trains so far due to financial constraint.³⁵ The NAB also declared it a mega scandal of 480 billion rupees and submitted to the Supreme Court (SC) of Pakistan.³⁶

The report of the Auditor-General of Pakistan identified that wastage of assets, fraud, disappointment in recuperating outstanding payments and other financial anomalies adding up to billion of rupees resulted in such a big disaster. According to the audit report, PR management decimating to recover 310.34 million rupees of maintenance and operation charges from the department of Defence, WAPDA and other government institutions for a considerable length of time.³⁷

Moreover, PR additionally sustained a loss of 1,324.13 million rupees because of not paying the amount of lease and rental charges from numerous government and private associations. The careless administration, faulty internal framework and carelessness had charged two billion rupees. Because of the absence of an appropriate governance mechanism, irresponsible management, over employment and corruption from lower level to the top administration devastated PR which was the most revenue generated institution.³⁸

Last but not least, the most recent example of a biggest CG failure and mismanagement is Nandipur Power Project (NPP). NPP is 425 MW (with potential of 1000 MW) joint cycled thermal Power Plant. The project was built by China Dongfang Electric Corporation (CDEC) and finished in March 2015. The potential expenses of the project was 23 billion rupees (\$329 million) when it was proclaimed, which according to the current GOP Muslim League Nawaz (PMLN),

³⁴ Rukhsar Ahmed and Imam ud Din, 'Failure of Corporate Governance in Pakistan Railway' (2013) 4(5) International Journal of Multidisciplinary Science and Engineering 48

³⁵ Ibid

³⁶ The information is collected from the NAB website <www.nab.gov.pk> or <<http://propakistani.pk/2015/08/05/nab-includes-ptcl-privatization-case-in-its-list-of-29-scandals-submitted-to-sc/>> accessed 30 September 2015

³⁷ 'Audit Report 2012-13: irregularities, embezzlement detected in Railways' <<http://www.brecorder.com/business-and-economy/189:pakistan/1224000:audit-report-2012-13:-irregularities-embezzlement-detected-in-railways?date=2013-08-23>> accessed 25 June 2015

³⁸ Ibid (n 34) 49

increased to 57.38 billion rupees because of the postponement, carelessness and negligence of the former government of Pakistan People's Party (PPP). Notwithstanding, it is likewise guaranteed that the real cost has reached to 84 billion rupees.³⁹

Pakistan Electric Power Company (PEPCO) had a contract of 23 billion rupees with CDEC in January 2008 and paid 10 per-cent of down payment to CDEC. By the middle of 2010, the major work of this project was done and it was anticipated to be completed in 2011. But the project has to be delayed because of the reason that the Ministry of Water and Power (MWP) sent summary to Ministry of Law and Justice (MLJ) for legal opinion which remained stuck for two years from March 2010 to March 2012. Consequently, the machinery worth \$85 billion dollar stayed stuck at Karachi port.

Due to this the CDEC terminated the construction contract of this project in September 2012 saying that their machinery worth \$85 million got wasted because it could not get clearance on Karachi port. The CDEC also claimed compensation of \$40 million for lose they suffered due to the damage and depreciation to machinery. Whether GOP paid CDEC all this amount of \$85 million of machinery and \$40 million of compensation is not known.⁴⁰

In June 2013 current PMLN government came into power and the MWP started negotiations with CDEC to resume the contract. After a series of negotiations, CDEC agreed to resume the contract and in July 2014 engineers of CDEC came to Pakistan and to inspect machinery at Karachi port to resume construction. However, it was the same machinery, CDEC claimed that it was damaged and

³⁹ The Express Tribune, 'Nandipur Power Plant: Officials Pass the Buck as Project Fails to Kick Off' (12 October 2015) <<http://tribune.com.pk/story/971393/nandipur-power-plant-officials-pass-the-buck-as-project-fails-to-kick-off-national/>> accessed 20 November 2015; The Dawn News, 'Nandipur Power Plant Failure: What Needs to be Probed?' (13 September 2015) <<http://www.dawn.com/news/1206683>> accessed 20 November 2015; The News, 'Failure of Nandipur Project a Result of Bureaucratic Incompetence' (12 September 2015) <<http://www.thenews.com.pk/print/62066-failure-of-nandipur-project-a-result-of-bureaucratic-incompetence>> accessed 20 November 2015

⁴⁰ Ibid; Mazhar Hussain, 'Development of Low Head Hydropower Projects on Canals in Punjab Pakistan' (2014) Pakistan Engineering Congress Paper No. 719, 251 <<http://pecongress.org.pk/images/upload/books/12-Mazhar%20Hussain.pdf>> accessed 20 December 2015

destroyed, that is why CDEC claimed machinery cost and compensation cost from GOP. Later when they resumed construction work they used the same machinery. The Prime Minister initiated the primary turbine of project on 31 May 2014. But sadly, the plant remained operative just for five days after inauguration and had to be closed down due to the bad governance, maladministration and inappropriate utilisation of fuel.

It is claimed that the total cost of this project has reached to 84 billion rupees which also includes a huge corruption.⁴¹ The apparent few reasons of this CG failure are: firstly, it is not clear that who is the chief supervisor of this project; either he is Khawaja Asif (MWP), Shahbaz Sharif (Chief Minister of Punjab) or Abid Sher Ali (State MWP).

Secondly, the CDEC is the same company which was black listed due to providing defective engines to PR. Why this contract was given to a black-listed company? Who is responsible for such negligence?

Thirdly, there is acute lack of planning and management, GOP seems to be over ambitious without proper paperwork. The project management is nowhere.

Last but not least, this project was the failure of previous government, in spite of doing its audit and accountability of responsible individuals for wasting public money, the current government resumed it without conducting proper paper work.⁴²

These are few examples⁴³ among many of CG failures in SOEs which occurred due to bad governance, mismanagement and high level of corruption. The former commissioner of SECP Etrat Hussain Rizvi said in one of his interviews that:⁴⁴

⁴¹ The Daily Times, 'OPP Demands NAB Investigate Nandipur Project Corruption' (8 October 2015) <<http://www.dailytimes.com.pk/national/08-Oct-2015/opp-demands-nab-investigate-nandipur-project-corruption>> accessed 20 November 2015

⁴² Ibid (n 39, 41)

⁴³ Discussed in above paragraphs.

⁴⁴ Ibid (n 28) Faryal Salman and Kamran Siddiqui, 'Corporate Governance in Pakistan: From the Perspective of Securities and Exchange Commission of Pakistan' (2013) 12(4) 13

The SECP is doing every effort for the development of CG in Pakistan; however I have questions about the governments' part in light of the fact that they demonstrate almost no ability to implement CCG. In larger public companies such as, Oil and Gas Development Company Limited (OGDC) and Pakistan State Oil (PSO), the BODs were selected on the premise of their common legitimacy for example, two directors among every four territories. Regardless of the possibility that we have political purposes behind doing as such, we can choose the BODs from every one of the four corners of the country in view of legitimacy instead of nepotism.

Moving further, families are the second key stakeholders after state in the business of Pakistan as most of the companies in both public and private sector are FOEs,⁴⁵ and sadly, CG does not exist in FOEs according to the former Commissioner of SECP, Mr Etrat Hussain Rizvi.

The number of FOEs listed on KSE was 800 which have reduced to 600 now. The number is reduced due to the mergers and delisting of many family companies because they find the compliance with CG principles very cumbersome.

Another reason is that these FOEs disintegrate after their third generation. Likewise, the additional reason of lack of enforcement of CCG is that there are many public companies but there BODs are family members. The examples of family-owned business are textile sector, leather industry, construction companies, chemicals, agriculture, sports and entertainment products, carpets and rugs etc.

The examples provided in this section of CG failures in state-owned and family-owned businesses in Pakistan confirm the weak CG framework of Pakistan and the existence of problem in the enforcement mechanism of Pakistan. The faulty

⁴⁵ SECP (n 22); Nasir Afghan and Tayyaba Waqar, 'Succession in Family Businesses of Pakistan: Kinship Culture and Islamic Inheritance Law' (2007) CMER Working Paper No. 07-54 <<https://core.ac.uk/download/files/153/6257372.pdf>> accessed 20 December 2015; CDC, 'Corporate Governance With Respect to Family Owned Businesses in Pakistan' <<http://www.icap.org.pk/info/pdf/CDC.pdf>> accessed 20 December 2015

enforcement mechanisms and inappropriate implementation of CCG are responsible for the lack of accountability, transparency, fairness and defective disclosure statements of Pakistani companies.

Therefore, this thesis seeks to investigate these factors responsible for non-implementation of CG principles in Pakistan and formulate proposals and measures to improve the application and enforcement of CCG in Pakistan. However, it is important to clarify here that investigating enforcement mechanisms is one of the objectives of this thesis to lead towards achieving the main aim of this study.

1.2.2.2 The Corporate Laws of Pakistan (Law in Books)

This section discusses the legal environment in Pakistan regarding the hierarchy of corporate laws. The intention is to provide a context, background and an overview of the regulatory system under which the corporate sector of Pakistan is working.

A country's growth relies upon the organisation of laws and strategies developed to a large extent and for that purpose law should be dynamic not stagnant, so that it could be changed according to the requirements, needs and changing circumstances of a specific governing system; as static laws and procedures strangle business development, performance and economic growth.⁴⁶

Hence it is necessary to update laws and regulations according to changing needs for giving motivation to economic development. The weak legal and regulatory system creates institutional insecurity and uncertainty due to which shareholders specifically institutional investors (IIs) do not prefer to invest their money in such unprotected environment and this institutional uncertainty therefore stifles market growth. The aim of establishing sound CG mechanisms is to safeguard the profit

⁴⁶ Erik Berglof and Stijn Claessens, 'Enforcement and Corporate Governance' (2004) World Bank Policy Research Working Paper 3409, 41
<http://papers.ssrn.com/so13/papers.cfm?abstract_id=625286&download=yes> accessed 10 May 2015; Roscoe Pound, 'Law in Books and Law in Action' (1910) 44 American Law Review 12

for shareholders on their investments.⁴⁷ Therefore, jurisdictions having ineffective CG structures cannot create positive changes for the upgrading of investment mechanisms and economic progress.⁴⁸

The development of CG and reforms in the corporate framework also requires political support like other economic and legal institutions.⁴⁹ The researcher submits that the reforms are essential for developing economies, for example Pakistan where CG bodies are fragile and cannot provide protection to shareholders.⁵⁰

The following figure 1.1 shows the different sources of CG applicable in Pakistan. The researcher submits that whilst there are several corporate laws however, the problem lies in the proper enforcement of these laws; the weak and out-dated provisions of these laws is a significant issue and hurdle not allowing the CG of Pakistan to grow in its entirety.

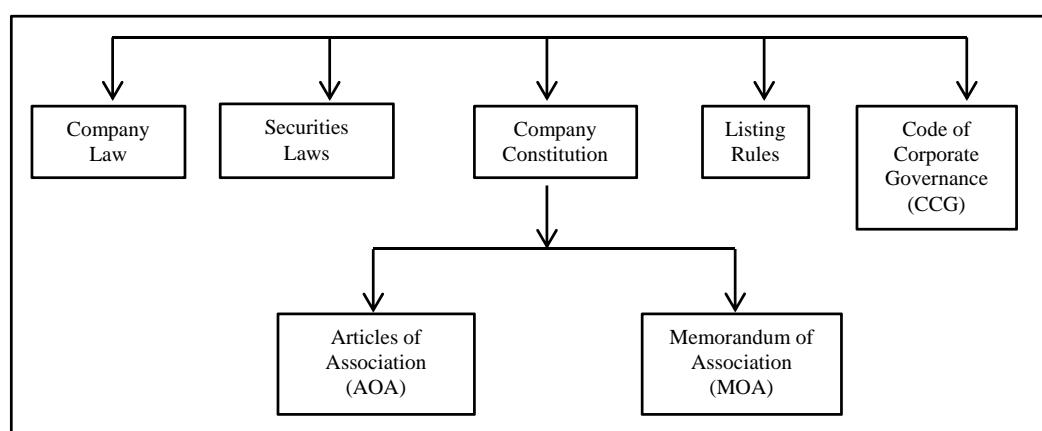


Figure 1.1: Sources of Corporate Law in Pakistan⁵¹

⁴⁷ Ronald Gilson, 'Corporate Governance and Economic Efficiency: When Do Institutions Matter?' (1996) 74 Washington University Law Quarterly 327, 340

⁴⁸ Amar Bhidé, 'Efficient Markets, Deficient Governance: US Securities Regulations Protect Investors and Enhance Market Liquidity. But Do They Alienate Managers and Shareholders?' (1990) 72 Harvard Business Review 128

⁴⁹ Andrei Shleifer and Robert Vishny, 'A Survey of Corporate Governance' (1997) 52(2) The Journal of Finance 737, 738

⁵⁰ As evidenced in section 1.2.2.1

⁵¹ Developed by the researcher

Company law is the key source of CG in Pakistan, which means that CG principles were already present in Pakistan's Company Law even before the formulation of CCG; however the problem remained the same that they could not be implemented.⁵² Company law (the Companies Ordinance 1984) is the fundamental legislation that accommodates the rights and obligations of all stakeholders, distributes the power among directors and shareholders, voting powers to shareholders and the authority to issue shares. However, the application of company law is partially confined, depending on the kind of a company. For example, for public companies, company law provides stringent conditions as compared to private companies, in order to protect public interest.⁵³

The company's constitution consists of Articles of Association (AOA) and Memorandum of Association (MOA). The MOA⁵⁴ serves as the constitution of the company and declares the nature of business of a respective company. In case a company leads a business in contrast to its MOA or other than stated in its MOA, the directors of that company might be held responsible and penalised for this infringement.

The AOA⁵⁵ has secondary position after MOA and deals with the internal regulatory structures of companies. It deals with the internal matters of the company. The AOA contains CG provisions relating to the voting rights; appointment and elimination of directors; the authorities of directors; variation in rights and privileges. The AOA are a significant source of CG matters in a company.

⁵² Chaudhary AG, *Company Law in Pakistan: A Commentary on the Companies Ordinance, 1984* (Reprint edition 2011-2012, Khyber Publishers Lahore 2012) "See generally"

⁵³ Part IV of the Companies Ordinance 1984

⁵⁴ Part III of the Companies Ordinance 1984

⁵⁵ Part III of the Companies Ordinance 1984

Moreover, Securities Laws (SL)⁵⁶ and Listing Rules (LR)⁵⁷ also have considerable importance in CG as they provide protection to shareholders in the form of prevention on insider trading in the matters relating to the way in which the public offering is managed and transaction of shares is organised.⁵⁸ They are applicable only to those public companies who managed to raise capital from public.

Furthermore, another significant source of CG is the CCG. The CCG provides the basic principles of CG that are applicable to all types of companies in Pakistan. The researcher argues that the CCG is important because it can provide the solution for those issues which are not covered in other corporate laws. For example, it can provide guidelines to enhance the effectiveness of BODs and the protection of investors.

Therefore, the CCG might complement the legal structure, particularly in areas relating to which states are hesitant or not able to incorporate and implement governance standards via legislation due to political causes or costs; and those governance standards might be incorporated in states' legal structure when they have developed and been acknowledged by the business community.⁵⁹

The first draft of CCG in Pakistan as discussed above, was formulated and implemented in 2002 and was revised in 2012 with some changes. However, the CCG still requires amendments as it contains some weak and overlapping provisions with other corporate laws which cause inappropriate implementation of CCG.

⁵⁶ Part X of the Securities Act of Pakistan 2015

<http://www.secp.gov.pk/corporatelaws/pdf/2015/SecuritiesAct_2015.pdf> accessed 20 June 2015

⁵⁷ SECP, 'Guide for Listing of Companies through Initial Public Offerings'

<http://www.secp.gov.pk/Guides/Guide_Listing_Companies_Initial_Public_Offerings.pdf>

accessed 20 June 2015

⁵⁸ Khilji Miftahuddin, *Corporate Governance in Pakistan: An Analytical Study* (Lambert Academic Publishing 2011) "See generally"

⁵⁹ Ruth Aguilera and Alvaro Cuervo-Cazurra, 'Codes of Good Governance Worldwide: What is the Trigger' (2004) 25(3) *Organisation Studies* 417, 438; Eddy Wymeersch, 'The Corporate Governance "Codes of Conduct" Between State and Private Law' (2007) Working Paper Series, WP 2007-07, 28-9 <http://papers.ssrn.com/so13/papers.cfm?abstract_id=1032596> accessed 10-01-2015

Therefore, this thesis seeks to investigate the CCG of Pakistan, identify its weaknesses and formulate recommendations in order to make a more efficient and effective CCG for Pakistan. The researcher believes that, the formulation of an efficient and effective CCG will help to improve CG in Pakistani companies.

1.3 Research Aim and Objectives

This research intends to examine the CG framework of Pakistan, identify its weaknesses, to establish the importance and advantages of CG principles and to formulate recommendations for the improvement of CG in Pakistan. Therefore, the main aim of this thesis is:

- To develop a CG model for the listed companies of Pakistan to improve the CG practices beyond a minimalist approach.

For this purpose, the four variables/objectives have been chosen whose answers will lead to achieve the main aim of this thesis. Those four objectives are as follows:

1. To investigate the CCG of Pakistan, identify its weaknesses and make recommendations to develop a more effective CCG. (Chapter Four)
2. To investigate the enforcement mechanisms of Pakistan relating to corporate matters, identify its lacunae and develop measures to improve it by exploring the role of the courts and capital market to enhance the implementation and enforcement of CG principles in the listed companies of Pakistan. (Chapter five)
3. To investigate the role of BODs in improving CG principles and develop a 'Board Effectiveness Model' for the listed companies of Pakistan. (Chapter Six)
4. To investigate the role of institutional investors and explore the ways for their enhanced role in improving CG practices in the listed companies of Pakistan (Chapter Seven)

1.4 Research Questions

1. Why does the CCG important for companies and what could be the form of an effective and efficient CCG for the listed companies of Pakistan?
2. How could the implementation and enforcement of CCG be improved in the listed companies of Pakistan by reforming the enforcement mechanisms of Pakistan?
3. How do the BODs affect the CG of their companies and what could be the model of an effective Board for the listed companies of Pakistan?
4. What role can institutional investors play in order to promote CG principles in the listed companies of Pakistan?

1.5 Rationale and Significance of this Study

CG has become considerably important in the contemporary corporate world due to the financial disasters and corporate scandals worldwide.⁶⁰ These incidents (corporate scandals) elucidate that the absence of CG allows insiders, whether they are company managers, directors or public officers, to expropriate companies at the cost of investors and other stakeholders.⁶¹ Therefore, companies with fragile and ineffective CG frameworks are mostly expected to face severe consequences beyond financial scams in today's globalised economy. As a result, there is an increased demand to adopt CG principles.

As discussed and evidenced in section 1.2, the corporate framework of Pakistan is in its developing stage.⁶² The listed companies of a country (both SOEs and FOEs) have a considerable role in the growth of its economy, therefore it is necessary that the governance level of these companies should be of high level and fulfil the standards of transparency and accountability according to the CG principles.

⁶⁰ Ibid (n 1-3, 10)

⁶¹ Ibid (n 1-3, 10)

⁶² Ayaz Ahmad and Henna Ahsan, 'Contribution of Services Sector in the Economy of Pakistan' (2011) PIDE Working Papers Pakistan Institute of Development Economics (PIDE) <<http://www.aub.edu.lb/fas/ife/PublishingImages/Performance%20and%20%20Credit%20Risk%20in%20Banking.pdf>> accessed 20 June 2015

Hence, this research intends to add to this continuous debate on the benefits of CG principles specifically in regards to Pakistan in following ways:

The aim of this thesis is to develop a CG model for Pakistan which could lead towards the advancement of CG practices in the country beyond a minimalist approach. To achieve this purpose four variables are selected to investigate.

First, this thesis intends to examine the CCG, as in the initial phase of reform ‘law in books’ should be reformed first.⁶³ The sound laws, rules and regulations are primarily necessary for structuring a strong system.⁶⁴ For this purpose, the both CCG (2002 and 2012) has been thoroughly investigated, the weaknesses in the provisions of CCG have been identified and the recommendations have been formulated in order to update the CCG.

While formulating the recommendations, the guidance has been obtained from the Combined Code of the UK. The reason for choosing the UK for guidance is that most of the laws of Pakistan including corporate laws and the CCG are already based on UK’s laws; Pakistan being the former colony of the UK.⁶⁵ As discussed in section 1.2, while formulating the first draft of CCG for Pakistan, guidance was taken from the CCG of the UK and the OECD principles of CG.⁶⁶ Therefore, this thesis gets guidance from the CCG of the UK and from the OECD Principles of CG to formulate recommendations in order to amend the existing CCG of Pakistan and redraft a new one.

The second way to achieve the aim of this thesis is to investigate the enforcement mechanism of Pakistan in relation to CG. As has been discussed in section 1.2.1, CCG has not been implemented properly in the listed companies of Pakistan due to weak enforcement mechanisms. The enforcement of laws is also important in the current era of globalisation and competition when cross-border investments

⁶³ Roscoe Pound, ‘Law in Books and Law in Action’ (1910) 44 American Law Review 12

⁶⁴ Ibid

⁶⁵ For example, the Companies Ordinance 1984 of Pakistan is the same as documented by the British-India before in 1932 before partition with some amendments (the detail evidence is provided in chapter five).

⁶⁶ SECP, ‘Manual of Corporate Governance’ (2014) <www.secp.gov.pk> or <<http://www.nzibo.com/IB2/manual-CG.pdf>> accessed 1 February 2015

have increased.⁶⁷ A legitimate framework can work successfully only if the framework to control is also effective for setting out an organised mechanism of check and balance. It is important for the second phase of reform, as without ‘law in action’ there is no use of ‘law in books’, no matter how strong these laws are.⁶⁸

Therefore, this thesis intends to investigate enforcement mechanisms of Pakistan and explore ways to reform these mechanisms by reforming the judiciary and capital market of Pakistan. The capital market and judiciary are the principal sources of enforcement of corporate laws in Pakistan.⁶⁹ The aggrieved party can file a complaint in SECP, if s/he could not get proper remedy from SECP, s/he can file a complaint and go to the court. However, there are a number of irregularities⁷⁰ in both institutions regarding enforcement which this thesis seeks to investigate and formulate measures to remove those irregularities and enhance the efficiency of these institutions relating to the enforcement of corporate matters.

The third way to accomplish the aim of this thesis is to examine the effectiveness of BODs in the listed companies of Pakistan by investigating the impact of their size, diversity, composition and independence. The aim is to develop a ‘Board Effectiveness Model’ for the listed companies of Pakistan. For this purpose guidance is taken from the prior studies (both theoretical and empirical) conducted in different jurisdictions particularly from the King II Report, King III Report and the LR of Johannesburg Securities and Exchange Commission (JSE) of South Africa.

The reason to get guidance from South Africa is that, the South African corporate boards are more diverse than any other Boards of any country including European Whites or Caucasians, Chinese, Indians, Mixed Race and Black Africans. The empirical research done on the 117 listed companies of South Africa in 2003

⁶⁷ Luca Enriques, ‘Do Corporate Law Judges Matter? Some Evidence from Milan’ (2002) 3 European Business Organisation Law Review 756, 812

⁶⁸ Ibid

⁶⁹ The evidence is provided in chapter five (see sections 5.4 and 5.5)

⁷⁰ See section 5.4 and 5.5

established a considerably affirmative connection between the mixture of BODs and companies' outcome,⁷¹ so as the other variables of board's size, composition and independence.⁷²

The researcher believes that the effectiveness of BODs is essential in creating shareholder value,⁷³ because good internal controls help in aligning managerial interests with that of shareholders and BODs is the central part of any CG structure.⁷⁴ Only BODs can help to increase the implementation of CCG in a company, however the BODs in Pakistan's listed companies are not independent and do not follow CCG, in fact they are not being appointed themselves according the corporate laws (Companies Ordinance 1984 and the CCG).⁷⁵

Therefore, it is essential to develop a board effectiveness model for the listed companies of Pakistan which would also create awareness among the management of companies regarding the benefits of CCG and help in promoting CG principles in the listed companies of Pakistan. Such work has not been done previously relating to Pakistan.

The fourth way to achieve the aim of this study is to explore the part of institutional investors (IIs) in promoting CG norms in the listed companies of Pakistan. The IIs are large organisations/institutions who collect money from individual shareholders or companies and invest that money in large companies.⁷⁶ They can influence their investee companies, change share values and move resources in and out of investee company, with huge impacts on their costs and

⁷¹ Naomi Swartz and Steven Firer, 'Board Structure and Intellectual Capital Performance in South Africa' (2005) 13(2) *Meditari Accountancy Research* 145; Institute of Directors Southern Africa, 'South Africa is a Leader in Gender Diversity on Corporate Boards, Says New Study' (2013) <<http://www.iodsa.co.za/news/135560/South-Africa-is-a-Leader-in-Gender-Diversity-on-Corporate-Boards-says-New-Study.htm>> accessed 20 December 2015

⁷² Coles *et al.*, 'Boards: Does One Size Fit All' (2008) 87(2) *Journal of Financial Economics* 329; Jeffrey Sonnenfeld, 'What Makes Great Boards' (2002) 80(9) *Harvard Business Review* 108

⁷³ Michael Jensen and William Meckling, 'Theory of the Firm: Managerial Behaviour, Agency Cost and Ownership Structure' (1976) 3(4) *Journal of Financial Economics* 305

⁷⁴ Martin Lipton and Jay Lorsch, 'A Modest Proposal for Improved Corporate Governance' (1992) 48(1) *Business Lawyer* 59

⁷⁵ As discussed in section 1.2.1 and 1.2.2

⁷⁶ Chris Mallin, 'Trustees, Institutional Investors and Ultimate Beneficiaries' (2004) 12 (3) *Corporate Governance-An International Review* 239

hence economy in general. Being experienced and experts they can also contribute to increase the independence and competence of BODs.⁷⁷

Currently two types of IIs are working in Pakistan: Government-Owned IIs including, banks, Development Financial Institutions (DFI), National Investment Trust (NIT) and Investment Corporation of Pakistan (ICP); and private-owned IIs which includes, banks, DFI, insurance companies, mutual funds, modarbas and leasing companies.⁷⁸ However, their role is limited in Pakistan generally and particularly relating to CG, as they are working mostly with banks, in fact they have representation in the BODs of banks.⁷⁹ Though, there is a considerable potential for IIs to improve their role in CG⁸⁰ which this thesis aims to explore to improve CG in the listed companies of Pakistan.

In short, this study not only contributes in the existing literature of CG but also offers noteworthy theoretical and practical contributions to this essential area. The most significant and commonly used terms ‘corporate governance’⁸¹ and ‘Institutional Investors’⁸² are defined in this chapter; however there are several other terms of CG used in this study and they are defined in Glossary.

1.6 Structure of this Thesis

This thesis is divided into eight chapters sketched in figure 1.2. The brief synopsis of each chapter is presented below.

Chapter One: First chapter provides the introduction to this study. It presents the background of this research. It identifies the significance and challenges of the corporate sector of Pakistan. It provides aim, objectives, research questions, rationale and significance of this study.

⁷⁷ Petra Nix and Jean Chen, *The Role of Institutional Investors in Corporate Governance: An Empirical Study* (Palgrave Macmillan 2013) “See generally”

⁷⁸ Shah Nawaz Mahmood and Haroon Sharif, ‘Institutional Shareholders and their Role in Promotion of Corporate Governance in Pakistan’

<www.secp.gov.pk/IACCD/pub_iaccd/WORKING%20PAPER.pdf> accessed 20 March 2014

⁷⁹ Ibid

⁸⁰ Ibid (n 77, 78)

⁸¹ It is defined at the start of section 1.2

⁸² It is defined in section 1.5 and 2.4.5

Chapter Two: The second chapter intends to conduct a detailed literature review on CG. It also presents the theoretical considerations of CG relevant to this study. This chapter also explains the OECD principles of CG and their identical provisions like the CCG of Pakistan. It further analyses the literature relating to the compliance and enforcement of CCG. Additionally, it analyses the prior studies on the role and responsibilities of BODs. It examines studies establishing the role and importance of IIs in today's corporate world. This chapter also identifies the gaps in literature and explains how this study is going to address these gaps. Lastly, the summary of this chapter is presented under the heading of conclusion.

Chapter Three: The aim of chapter three is to provide details regarding the research methods and methodologies employed to conduct this study. It provides the research philosophy, research approach, and research strategy and research design of this study. It also explains the validity and reliability issues involved in qualitative studies and explain how these issues are handled in this thesis. It also presents the ethical considerations of this research.

Chapter Four: Chapter four intends to investigate the framework of CG in Pakistan and CCG prevalent in the country. It identifies the weaknesses and overlapping provisions of the CCG and formulates recommendations to improve those provisions in order to make them more effective and up-to-date. This chapter identifies the benefits of adopting and implementing the CCG in listed companies of Pakistan.

Chapter Five: Chapter five aims to examine the enforcement mechanisms in Pakistan in relation to CG. It identifies the factors which are responsible for the non-implementation of CG principles in the listed companies of Pakistan and formulate recommendations to improve enforcement mechanisms which are essential for the growth of CG principles in the listed companies of Pakistan.

Chapter Six: This chapter examines the role and responsibilities of BODs. It analyses the factors which help to make BODs effective and efficient in making policies and strategic decision for the companies such as, diversity, size,

composition and independence of BODs. It also investigates the effectiveness of BODs in the listed companies of Pakistan and develops a 'Board Effectiveness Model' for the listed companies of Pakistan.

Chapter Seven: This chapter aims to explore the role of IIs for promoting the CG practices, analyses their working mechanisms and provide recommendations to improve their role and also suggest new ways in which they can play their part more effectively for the growth of CG principles in the listed companies of Pakistan.

Chapter Eight: Chapter eight is the final chapter and presents a brief summary of findings and an overall conclusion from the analysis in the previous chapters. Keeping in mind the end goal to draw down the ultimate findings, the main results from the four core chapters (from chapter four to seven) are united in the final chapter. The limitations of this study and numerous suggestions for future research are also presented in this chapter.

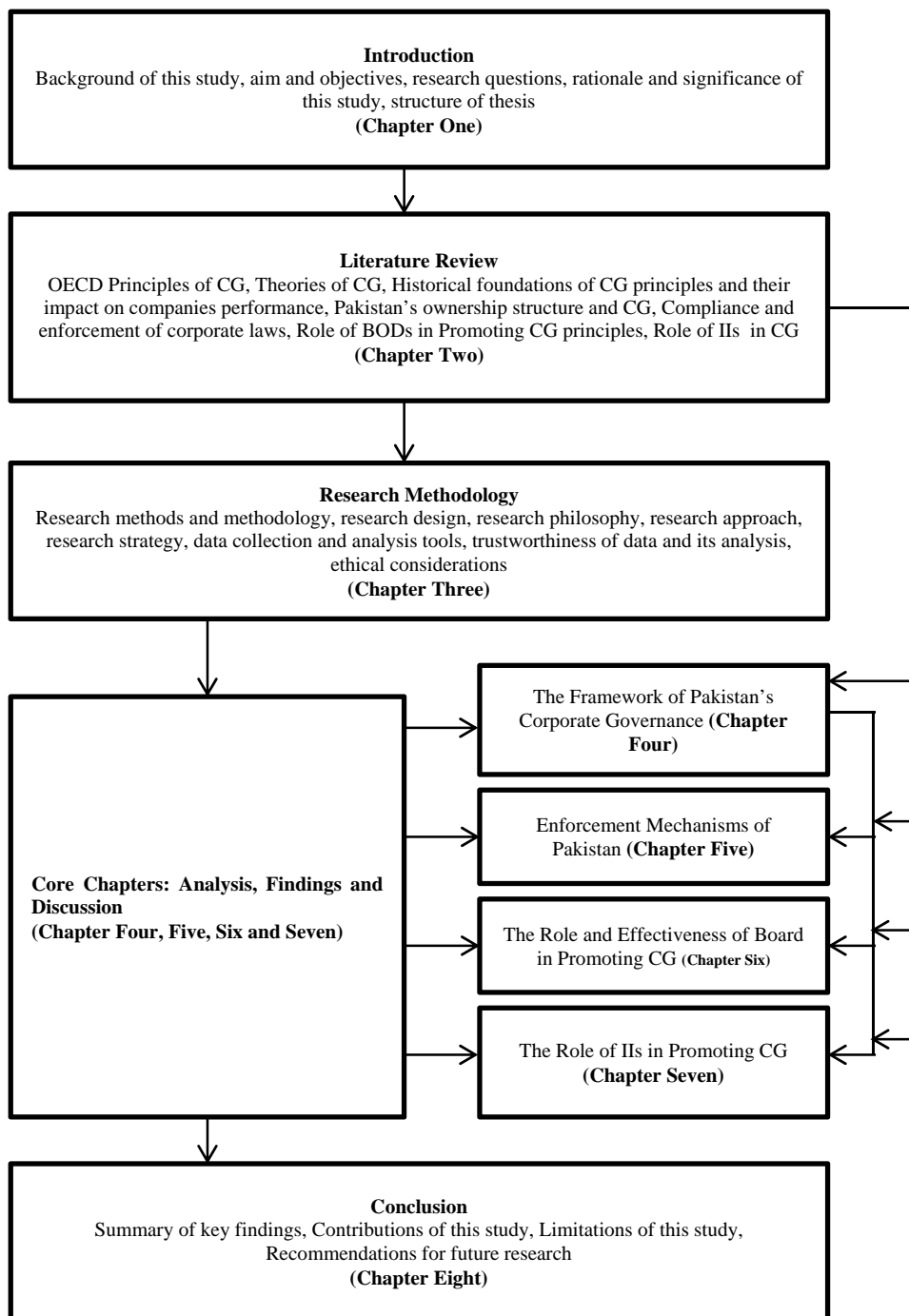


Figure 1.2: Structure of this Thesis

CHAPTER TWO: LITERATURE REVIEW

2.1 Introduction

The aim of this chapter is to present a detailed literature review on corporate governance (CG) in order to establish the effectiveness of CG norms in companies and institutions. It seeks to summarise a stream of research that has provided an insight into the concepts, theoretical work and empirical research done previously on the importance of CG principles, their compliance and enforcement, the role and effectiveness of board of directors (BODs), and the significance and part of institutional investors (IIs) in promoting CG practices.

The previous studies provide evidence that good CG principles enrich the company's value. This chapter is aimed at exploring the relevance of previous studies to this research and to provide a perspective of different schools of thought on the issues of enforcement of CG principles, effectiveness of BODs and the part of IIs in CG (which are the objectives of this study) in order to establish the significance of this thesis.

This chapter provides a comprehensive discussion and analysis of existing literature and identify the deficiency of research relating to CG issues particularly in Pakistan which establish the originality of this work and its meaningful contribution to the existing knowledge. Figure 2.1 gives a plan of this chapter.

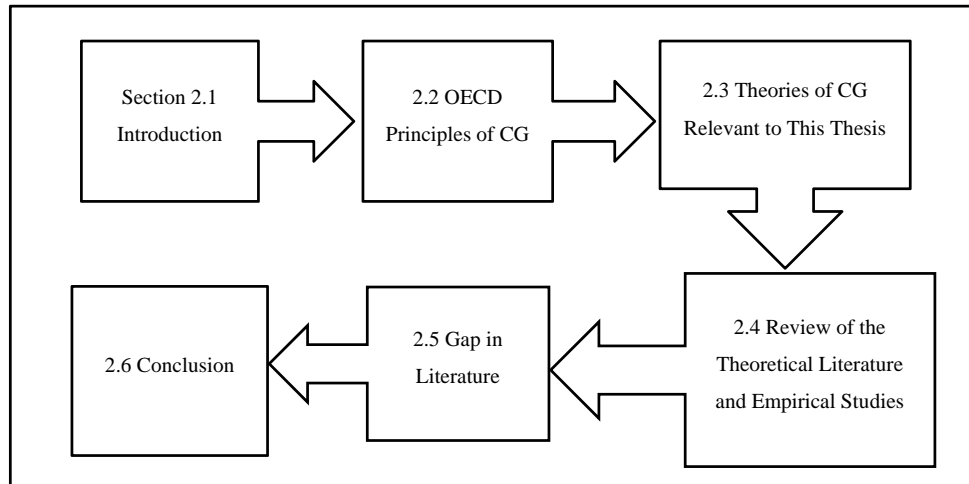


Figure 2.1: Plan of this Chapter

2.2 OECD Principles of Corporate Governance

As discussed in chapter one CG is a wide term which describes the means, framework and the procedures through which a company's affairs are directed and monitored. The CG also increases the shareholder value in the long run by the procedure of accountability of directors and by increasing the returns of a company.¹ When the directors of a company will be accountable to shareholders, they will perform their duties more responsibly and will take higher strategic decisions for the company. Such practices increase the share values along with the better performance of a company. CG additionally reduces the conflict of ownership and control² by describing the interest of shareholders and directors individually.

¹ Michel Aglietta, 'Shareholder Value and Corporate Governance: Some Tricky Questions' (2000) 29(1) *Economy and Society* 146; Humera khan, 'A Literature Review of Corporate Governance' (2011) 25 *International Proceedings of Economics Development and Research* 1

² The conflict of interest between ownership and control also called the agency conflict is discussed in section 2.3.1. The aim of this section is to identify the role of CG to eliminate these conflicts.

The Principles of CG issued by Organisation for Economic Cooperation and Development (OECD)³ have been considered as standards for code of corporate governance (CCG) in a number of countries particularly in developing jurisdictions.⁴ The OECD has additionally issued a Survey of CG Developments in OECD countries.⁵ The European Corporate Governance Institute (ECGI) upholds several connections to codes of corporate conduct for several countries on its website. The OECD has further published various studies on CG in Asia, the most prominent being its White Paper on CG in Asia.⁶ The following sections provide the principles of CG devised by OECD which are relevant to the objectives of this thesis.

2.2.1 The Rights of Shareholders and Stakeholders

The OECD principles emphasise that the framework of CG should be devised in a manner that it could safeguard shareholders' rights, and ensure the fair treatment with all shareholders and stakeholders.⁷ A mechanism should be provided for investors to get actual compensation for infringement of their rights. Moreover, the rights of stakeholders should be recognised in CG framework as established by law and lively collaboration between stakeholders and companies should be encouraged in generating jobs, stability of economically strong companies and maximising the wealth of companies.⁸

³ OECD, 'The OECD Principles of Corporate Governance' (1999) 1 <www.oecd.org> accessed 20 June 2015

⁴ Robert McGee, 'Corporate Governance in Asia: Eight Case Studies' (2008) 1 <<http://ssrn.com/abstract=1081954>> accessed 01 March 2015

⁵ OECD, 'Corporate Governance: A Survey of OECD Countries' (2004) 17 <<http://www.oecd.org/corporate/ca/corporategovernanceprinciples/21755678.pdf>> accessed 10 January 2015

⁶ OECD, 'White Paper on Corporate Governance in Asia' (2003) 11 <<http://www.oecd.org/corporate/ca/corporategovernanceprinciples/25778905.pdf>> accessed 10 January 2015

⁷ OECD Principles of Corporate Governance, 1 <www.oecd.org/daf/ca/2014-review-oecd-corporate-governance-principles.htm> accessed 10 January 2015

⁸ Ibid

2.2.2 The Responsibility and Effectiveness of the Board

The OECD principles also accentuate that CG should guarantee the strategic assistance of the company, the active supervision of administration by the BODs, and the responsibility of BODs to shareholders and to the company. Similarly, the correct and timely disclosure should also be ensured regarding all substantial matters of the company, including ownership, governance, financial situation, and performance of the company.⁹

As one of the objectives of this thesis is to investigate the effectiveness of BODs and formulate a 'Board Effectiveness Model' for Pakistani listed companies, so that the rights of shareholders could be protected and the supremacy of the BODs could be replaced with a transparent accountability mechanism. Although, Pakistan's CCG is formulated along the lines of the UK and OECD principles of CG, it is not proving as effective as in other countries such as the UK. This research investigates these reasons and proposes recommendations to close these gaps.

2.3 Theories of Corporate Governance Relevant to This Thesis

This section presents the related existing theories that connect internal CG structures and companies' financial and corporate performance. Theories underlying CG have been drawn from a range of subjects, involving accounting, economics, finance and law.¹⁰ Clarke¹¹ provides a comprehensive detail of these CG theories.

⁹ OECD Principles of Corporate Governance (2004)
<www.oecd.org/corporate/ca/corporategovernanceprinciples/31557724.pdf> accessed 10 January 2015

¹⁰ Kami Rwegasira, 'Corporate Governance in Emerging Capital Markets: Whither Africa?' (2000) 8(3) *Corporate Governance-An International Review* 258; Christian Mallin, *Corporate governance* (5th edition, Oxford University Press 2015) "See generally"; Jill Solomon, *Corporate Governance and Accountability* (2nd edition, John Wiley and Sons Ltd 2007) 16; Boris Durisin and Fulvio Puzone, 'Maturation of Corporate Governance Research 1993-2007: An Assessment' (2009) 17(3) *Corporate Governance: An International Review* 266

¹¹ Thomas Clarke, *Theories of Corporate Governance: Philosophical Foundations of Corporate Governance* (Routledge 2004) "See generally"

2.3.1 Agency Theory

Agency theory ascertains the agency relationship in which one party (the principal) delegates his authorities to another party (the agent). In the context of companies, the owners are the principal and the directors are the agent.¹² Agency theory is imitative from the studies of Berle and Means,¹³ Jensen and Meckling¹⁴ and Fama and Jensen.¹⁵ Jensen and Meckling describe an agency relationship:

“as an agreement through which one or more persons (the principal(s)) delegate their authorities to some other person (the agent) to act for their sake, for example, the authority to take decisions on behalf of them.”

Agency theory determine and resolve issues which emerge at the time when the benefits of principal and agent are in strife and when it is troublesome or costly for the former to check what the latter is performing for his sake. This theory proposes that the former can confine errors from his agent by sustaining so as to establish proper motivations for the agent and checking costs intended to restrict the irregular exercises of the agent.¹⁶ These may incorporate endeavours with respect to the principal to monitor the conduct of agent via contractual understandings in regards to remuneration approaches, working principles, spending budget confinements *inter alia*.

This thesis identifies (see section 5.3) that a large number of companies in Pakistan are family-owned enterprises (FOEs), which is a big hurdle in reforming the CG structure there. The members of a family dominate BODs usually and they

¹² Christine Mallin, *Corporate Governance* (4th edition, Oxford University Press 2013) 16

¹³ Adolf Berle and Gardiner Means, *The Modern Corporation and Private Property* (Harcourt, Brace and World 1932) “See generally”

¹⁴ Michael Jensen and William Meckling, ‘Theory of the Firm: Managerial Behaviour, Agency Costs and Ownership Structure’ (1976) 3(4) *Journal of Financial Economics* 308

¹⁵ Eugene Fama and Micael Jensen, ‘Separation of Ownership and Control’ (1983a) 26(2) *Journal of Law and Economics* 301; Eugene Fama and Michael Jensen, ‘Agency Problems and Residual Claims’ (1983b) 26(2) *Journal of Law and Economics* 327

¹⁶ *Ibid*

do not welcome CG reforms.¹⁷ Therefore this thesis recommends that the composition of BODs should be balanced with the equal number of executive and non-executive directors (NEDs) in order to undermine the family dominance on BODs.

In this case, the ownership of company will be separated from control which will obviously raise agency issues. The similar case is of state-owned enterprises (SOEs).¹⁸ The agency theory provides the guidelines for such cases to resolve the matter which arises from the parting of ownership from control.

2.3.2 Signalling Theory

Signalling theory can be utilised to elucidate the connection between CG systems and a companies' performance.¹⁹ It elucidates the behaviour when two parties have access to different information; and one party (a company) choose whether and how to signal (communicate) that information, and other party (shareholders, stakeholders) choose how to interpret the signal.²⁰

This theory was initially pushed with a specific end goal to clarify information asymmetry in the labour markets. From that point forward it has been produced in various different zones including disclosure of voluntary information.²¹

This theory recommends that in corporate reporting,²² companies that have confidence that they are 'better' than other companies flag this to shareholders and investment institutions to pull investments and good reputation.²³ Companies might ensure this by voluntarily revealing financial information in abundance of

¹⁷ Moin Fudda, 'Corporate Governance in Family-Owned Companies in Pakistan' (2014) 1 <<http://www.cipe.org/publications/detail/corporate-governance-family-owned-companies>> accessed 20 June 105

¹⁸ The State is the second largest stakeholder in Pakistani companies.

¹⁹ Michael Spence, 'Job Marketing Signalling' (1973) 87(3) The Quarterly Journal of Economics 355

²⁰ Brian Connelly *et al.*, 'Signalling Theory: A Review and Assessment' (2011) 37(1) Journal of Management 39

²¹ Stephen Ross, 'The Determination of Financial Structure: The Incentive-Signalling Approach' (1977) 8(1) The Bell Journal of Economics 23

²² Because of asymmetry in the market for the information

²³ Robert Verrecchia, 'Discretionary Disclosure' (1983) 5 Journal of Accounting and Economics 179

the requirement of law and other regulation. Correspondingly, not revealing can also be a sign in itself.

Nevertheless, companies would constantly desire to indicate that they are better than ordinary companies. Then again, companies will constantly have the desire to flag that they are superior to anything normal. In this manner they will prefer to pick disclosure over non-disclosure.²⁴ Henceforth, the harmony situation will be a complete revelation because almost all companies will have an impetus to uncover all progressive distinctive characteristics hypothetically with a specific end goal to maximise their individual egocentricity.

In like manner, companies may agree to CG standards to evidence to investors and different partners that they are being supervised in a better way and accordingly its worth putting resources into. Moreover, by appointing INEDs to the BODs, a company flags to potential shareholders its aim is to have connection with them reasonably, by ensuring their venture. By revealing adoption of CG standards (signalling), a company decreases information asymmetry.²⁵

One of the objectives of this thesis is to improve the enforcement mechanism in Pakistan. This thesis advocates that in order to improve CG in Pakistan's corporate market, the compliance with CCG should be enhanced; and disclosure is one of the key features of CCG. The CCG, require from companies to unveil in annual reports, their strategies, decision-making techniques and other working parameters transparently and explicitly. Such disclosure is not welcomed by some vested interest groups and business tycoons (see section 5.3). In such situation, signalling theory unveils the advantages attached with following the disclosure requirements which can encourage those reluctant groups to follow CG principles.

²⁴ According to signalling theory

²⁵ Amama Shabbir and Carol Padgett, 'The UK Code of Corporate Governance: Link between Compliance and Firm Performance' (2005) Working Paper ICMA Centre <<http://ssrn.com/abstract=934313>> accessed 01 March 2015; Black *et al.*, 'Does Corporate Governance Predict Firms Market Values? Evidence From Korea' (2006) 22 Journal of Law, Economics and Organisation 366

2.3.3 Stakeholder Theory

Freeman and Reed²⁶ characterise stakeholders as any gathering or person who can influence or is influenced by the success of a company and company's goals. Stakeholder theory is utilised to comprehend those groups and people that can influence and are influenced by the success of a company's motivation. This theory is classified in managerial stakeholder theory and ethical stakeholder theory.²⁷ The former branch unequivocally alludes to concerns of stakeholder force, and how a stakeholder's virtual force affects their capacity to 'drive' company into agreeing to their expectations.

Conversely, the latter branch contends that all stakeholders have the privilege to be dealt with reasonably by a company.²⁸ This theory might likewise be utilised to clarify why companies ought to comply with CG practices. For example, consistence with collective communal concerns as prescribed by the King III Report e.g. HIV/AIDS, group effort programs, livelihood value and so forth might be an endeavour by companies to demonstrate to further stakeholders their great corporate citizenship. Along these lines, this theory can be utilised to clarify consistence with CG standard norms in such manner.

2.3.4 Information Asymmetry

Prior studies²⁹ have relied on information asymmetry and managerial signalling as a supporting theory to elucidate the link between shareholders (principals) and managers (agents). It suggests that managers as insiders typically have more information than shareholders, including private information, about their companies.³⁰ Theoretically, by electing to comply with the recommendations of a

²⁶ Edward Freeman and David Reed, 'Stockholders and Stakeholder: A New Perspective on Corporate Governance' (1983) 25(2) California Management Review 88

²⁷ Craig Deegan and Jeffrey Unerman (Eds) *Financial Accounting Theory* (McGraw Hill 2014) 10

²⁸ Ibid

²⁹ Ibid (n 14) 309

³⁰ Paul Healey and Krishna Palepu, 'Information Asymmetry, Corporate Disclosure, and the Capital Markets: A Review of the Empirical Disclosure literature' (2001) 31 Journal of Accounting and Economics 405; Panayotis Kapopoulos and Sophia Lazaretou, 'Corporate Ownership structure and Firm Performance' (2007) 15(2) Corporate Governance: An International Review 144

CCG, a company will principally be signalling to shareholders that it is better-governed.

Consequently, investors will offer up share prices in light of the fact that with better CG, they are prone to get a more noteworthy part of their companies' benefits instead of being confiscated by directors.³¹ For example, by appointing INEDs to the BODs, a company gives indication to possible shareholders its expectations of having relationship with them decently, and for that matter the safety of their investment.

Likewise, by signalling (disclosing) its better governance qualities to investors, a company reduces information asymmetry. This is likely to lead to an increase in share price and company value for existing shareholders due to the potential increase in the demand for its shares.³² Equivalently, a growth in a company's share value should, *ceteris paribus*, end in a reduction in the price of outside equity capital.³³ A noteworthy route by which companies can creditably indicate their standards of excellence to the business market or potential investors is the adoption and implementation of CG standards.

2.3.5 Stewardship Theory

In contrast to agency, information asymmetry and signalling theories that give importance to managerial speculation and monitoring, stewardship theory posits that executive directors are intrinsically reliable persons.³⁴ Hence, they should be authorised completely to direct and manage companies due to the fact that they

³¹ LLSV, 'Investor Protection and Corporate Valuation' (2002) 57(3) The Journal of Finance 1147; Beiner *et al.*, 'An Integrated Framework of Corporate Governance and Firm Valuation' (2006) 12(2) European Financial Management 249

³² Black *et al.*, 'Corporate Governance Indices and Firm's Market Values: Time Series Evidence from Russia' (2006b) 7(4) Emerging Markets Review 361

³³ Christine Botosan, 'Disclosure Level and the Cost of Equity Capital: What Do We Know?' (1997) 72(3) Accounting Review 323

³⁴ Gavin Nicholson and Geoffrey Keil, 'Can Directors Impact Performance? A Case-based Test of Three Theories of Corporate Governance' (2003) 15(4) Corporate Governance: An International Review 588

are good wardens of the assets depended on them.³⁵ This theory marks numerous assumptions about the behaviour of senior managers.

Firstly, it undertakes that executive directors usually devote their whole working lives in that company they administer; they will probably have understanding of companies' affairs superior to anything NEDs thus can settle on better choices.³⁶

Secondly, they have more noteworthy formal and casual data and information regarding the company they manage, which can lead towards improved value of decision-making.³⁷ Consequently, advocates of stewardship theory stress that the improved financial returns of a company is prone to be connected with inner CG norms which confers greater powers to managers.³⁸

Stewardship theory contradicts the stance taken by this thesis, as this study advocates that there should be more INEDs as compared to executive directors on BODs. The argument taken is that the higher independent BODs ensure higher effectiveness for the financial and corporate performance of company, likewise more effective boards ensures higher protection of shareholders' interests.³⁹

2.3.6 Resource Dependence Theory

This theory is the final supporting theory of CG that this study relies on. It suggests that the institution of internal CG structures, such as BODs is not just vital for guaranteeing that the activities of managers are being monitored viably, additionally they serve as a necessary connection between company and the basic assets that it requires to enhance financial performance.⁴⁰

³⁵ Letza *et al.*, 'Shareholding Versus Stake-holding: A Critical Review of Corporate Governance' (2004) 12(2) Corporate Governance: An International Review 244

³⁶ Lex Donaldson and James Davis, 'Stewardship Theory or Agency Theory: CEO Governance and Shareholder Returns' (1991) 16(1) Australian Journal of Management 52

³⁷ Lex Donaldson and James Davis, 'Boards and Company Performance – Research Challenges the Conventional Wisdom' (1994) 2 Corporate Governance: An International Review 151

³⁸ Ibid (n 25) "See generally"

³⁹ The more detail on this contradiction is provided in section 2.4.5 and 6.4.

⁴⁰ Jeffrey Pfeffer, 'Size, Composition and Function of Boards of Directors: A Study of Organisational-Environmental Linkage' (1973) 18 Administrative Science Quarterly 350

For example, the BODs and NEDs in particular can provide necessary assets; for example, professional assistance, experience, impartiality, expertise and knowledge.⁴¹ Secondly, they can bring to the firm reputation and critical business contacts.⁴² Thirdly, the BODs can encourage admission to business elite, data, knowledge and capital.⁴³ Finally, the BODs provide an acute relationship to a company's outer environment and significant stakeholders, for example, creditors, suppliers, customers, and competitors. Therefore, it has been argued that more connections to the outer environment lead to have more access to assets.⁴⁴ This can impact positively on company's financial performance.

This theory validates one of the objectives of this thesis advocating the view that effective boards are necessary for the better performance of a company. Therefore, this topic is worthy of investigation.

2.4 Review of the Theoretical Literature and Empirical Studies

Many articles and books have been composed about CG in recent years alone. This section provides the detailed theoretical literature review and empirical studies on CG and CG issues which are being investigated in this study.

2.4.1 Historical Foundation of CG and the Impact of CG Principles on Companies' Performance

The literature review provided in this section confirms the significance of CG issues raised in this thesis and validates the objectives of this research.

Tricker⁴⁵ believes that earlier to the corporate collapse of 1980s the word CG was not being used, though CG principles were there and companies were using them in their governance mechanisms. However, the previous couple of years have

⁴¹ Roszaini Haniffa and Terry Cooke, 'Culture, Corporate Governance and Disclosure in Malaysian Corporations' (2002) 38(3) *Abacus* 319

⁴² Roszaini Haniffa and Muhammad Hudaib, 'Corporate Governance Structure and Performance of Malaysian Listed Companies' (2006) 33(7) *Journal of Business, Finance and Accounting* 1039

⁴³ *Ibid* (n 34) 600

⁴⁴ *Ibid* (n 34) 601

⁴⁵ Bob Tricker, *Corporate Governance: Principles, Policies and Practices* (3rd edition, Oxford University Press 2015) 4

noticed an outbreak of interest in CG around the world. The UK's Combined Code⁴⁶ exemplified the results of a set of three reports: the Cadbury Report,⁴⁷ the Greenbury Report,⁴⁸ and the Hampel Report.⁴⁹

The Cadbury Report (1992) issued the outcomes of the Committee on Financial Aspects of CG. The Greenbury Report (1995) discussed directors' remuneration. The Hampel Committee Report (1998) addressed the identical matters as the Cadbury and Greenbury reports. It has distinct divisions relating to the principles of CG, directors' role and responsibilities, their remuneration, the role of investors and accountability.

McGee⁵⁰ conducted a study of CG in eight Asian countries based on research undertaken by The World Bank.⁵¹ His research concluded with the overall unsatisfactory CG performance of its investee jurisdictions. However, he did not provide the clear and in-depth information as to what basis his study drew such conclusion; his work neither identifies the specific weaknesses of any countries' corporate system nor suggested any recommendations on the basis of which those countries may improve their corporate performance.

Moreover, Turnbull⁵² wrote about the corporate watchdogs, and limitations of CG best practices. Dignam⁵³ embellished much about the UK regulatory systems in a

⁴⁶ Combined Code, *Combined Code Principles of Corporate Governance* (Gee & Co Ltd London 1998)

⁴⁷ Cadbury Sir Adrian, *Report of the Committee on the Financial Aspects of Corporate Governance* (Gee & Co Ltd London 1992)

⁴⁸ Greenbury Sir Richard, *Directors' Remuneration* (Gee & Co Ltd London 1995)

⁴⁹ Hampel Sir Ronnie, *Committee on Corporate Governance: Financial Report* (Gee & Co Ltd London 1998)

⁵⁰ Robert McGee, 'Corporate Governance in Asia: Eight Case Studies' (2008) Working Paper 1 <<http://ssrn.com/abstract=1081954>> accessed 01 March 2015

⁵¹ The world Bank 2003; 2004a and b; 2005a, b and c; 2006a and b

⁵² Shann Turnbull, 'Corporate Watchdogs: Past, Present and Future?' (2002) 2 <<http://ssrn.com/abstract=608244>> accessed 10 March 2015; Shann Turnbull, 'How US and UK Auditing Practices Became Muddled to Muddle Corporate Governance Principles' (2005) <<http://ssrn.com/abstract=608241>> accessed 10 March 2015; Shann Turnbull, 'The Limitations of Corporate Governance Best Practices' in Thomas Clarke and Douglas Branson (eds), *The Sage Handbook of Corporate Governance* (Sage: London and Thomas Oaks 2012) 428

⁵³ Alan Dignam, 'Exporting Corporate Governance: UK Regulatory Systems in a Global Economy' (2000) 21(3) *Company Lawyer* 70; Alan Dignam and Michael Galanis, 'The Globalisation of Corporate Governance' (2009) <<http://ssrn.com/abstract=1839545>> accessed 20 February 2014; 'Capturing Corporate Governance: The End of the UK Self-Regulating System'

Global Economy. He discussed how the UK has a pioneer role in the development of CG best practices globally. Similarly, Armour⁵⁴ and Andersson⁵⁵ addressed the issues relating to CG in the UK in many ways. However, these studies were purely relating to the UK perspective, which provide an in-depth knowledge about the origin, importance and pros and cons of CG in the current changing world.

CG is a broad topic that encompasses the means by which ‘companies are administered and controlled’.⁵⁶ There are many drivers that influence the way in which companies are governed. They range from external factors such as regulators, shareholders/voters, capital markets, the takeover market, legal system and the press, to the internal drivers being the BODs, management and disclosure.⁵⁷ Arguably, the benefits of good governance have been generally recognised as evidenced by the plethora of governance codes and regulations that have been promoted or enacted globally since the Cadbury Report of 1992.

Aguilera and Cazorra⁵⁸ assert that, the jurisdictions that have adopted CCG seem to have developed the governance of their companies. Wignall *et al.*⁵⁹ wrote about the economic crisis of the world and the Great Depression. This researcher argues that these crises happened even in the presence of good CG principles. Therefore, there is a need to monitor these CG principles thoroughly and redraft them according to the requirements and need of companies working in different

(2007) 41 International Journal of Disclosure and Governance 24; ‘The Future of Shareholder Democracy in the Shadow of the Financial Crisis’ (2013) 36 Seattle University Law Review 639

⁵⁴John Armour, ‘Enforcement Strategies in UK Corporate Governance: A Roadmap and Empirical Research’ (2008) Law Working Paper No. 108/2008 <www.ecgi.org/wp> accessed 01 March 2015

⁵⁵ Jan Andersson, ‘Evolution of Company Law, Corporate Governance Codes and the Principle of ‘Comply or Explain’ – A Critical Review’ (2011) Nordic & European Company Law Working Paper No. 10-19 <http://papers.ssrn.com/sol3/papers.cfm?abstract_id=1869916> accessed 10 March 2015

⁵⁶ Jill Solomon, *Corporate Governance and Accountability* (4th edition, John Wiley and Sons Ltd 2013) 6

⁵⁷ Victoria Krivogorsky, ‘Ownership Board Structure, and Performance in Continental Europe’ (2006) 14 The International Journal of Accounting 176

⁵⁸ Ruth Aguilera and Cuervo-Cazurra, ‘Codes of Good Governance worldwide: What was the Trigger?’ (2004) 25(3) Organisation Studies 417; Ruth Aguilera and Cuervo-Cazurra, ‘Codes of Good Governance’ (2009) 17(3) Corporate Governance: An International Review 376

⁵⁹ Adrian Blundell-Wignall *et al.*, ‘The Elephant in the Room: The Need to Deal with What banks Do’ (2009) 11(2) OECD Journal: Financial Market Trends 1

jurisdictions having different cultural, social, political and working environments, and most importantly to ensure their enforcement.

Faryal and Siddique documented CG in Pakistan from the perception of Pakistan Institute of Corporate Governance (PICG)⁶⁰ and Securities and Exchange Commission of Pakistan (SECP).⁶¹ The perspective of SECP is based on an interview of former commissioner of SECP. Though this article has issue of validity due to the selection of very limited sample for interview (only one interview), and has not been corroborated with others opinion; therefore it may also has the issue in generalising its findings. However, the information provided in it is reliable because the interviewee is an experienced and reliable person. He has been the part of formulating first CCG for Pakistan.

This article explores the role of SECP in CG of Pakistan being an implementing and monitoring body. It also asserts that it is the responsibility of SECP to consult with related authorities whenever it formulates a new law, however it does not happen actually. The reason why it does not happen and a proper procedure is not being followed in formulation of a new law is not mentioned. Further this article also finds the FOEs and non-serious role of government as a major cause for CCG not being implemented and enforced properly in Pakistan, as identified in this thesis as well.

Being the opinion of former commissioner of SECP, it has considerable importance for this thesis as it validated the approach of this thesis to raise the enforcement issue as paramount importance declaring FOEs and government as a major factor in the non-implementation of CG principles. However, this article is limited to this issue, but this thesis goes far and investigated many other factors which are also responsible for the non-implementation and weak enforcement

⁶⁰ Faryal Salman and Kamran Siddiqui, 'Corporate Governance in Pakistan: From the Perspective of Pakistan Institute of Corporate Governance' (2013) 12(4) IUP Journal of Corporate Governance 17

⁶¹ Faryal Salman and Kamran Siddiqui, 'Corporate Governance in Pakistan: From the Perspective of Securities and Exchange Commission of Pakistan' (2013) 12(2) IUP Journal of Corporate Governance 13

mechanisms of CG in Pakistan (see section 5.3). Moving further, this thesis also recommends the measures to improve CG enforcement mechanisms in Pakistan.

In their second article, Faryal and Siddiqui highlight the role of PICG to create awareness regarding the benefits of implementing and adherence to CCG. This article is also based on one interview conducted from Mr Faud Azam Hashimi, the former President of PICG, and has the same methodology issues mentioned above relating to their previous article;⁶² however it also contains some very good points. This article takes the stance that though concentrated shareholdings⁶³ and related family transactions create conflict of interests but even then the number of corporate failures in Pakistan is less as compared to those countries where broad-based shareholdings culture prevail.

By saying this, Faryal and Siddiqui indirectly favour the culture of FOEs and consider it as an advantage of shareholdings being concentrated in few hands; likewise they also discourage apparently the presence of IIs. Hence, this article takes completely adverse position as compared to this thesis. This thesis discourage concentration of shareholdings in few hands and takes strong point that these vested interest groups do not let CG principles grow in the corporate sector of Pakistan; secondly this thesis considers IIs important for the development of CG norms, in fact it is one of the objectives of this thesis to explore the role of IIs in promoting CG in Pakistan.

Likewise, this thesis differs from them on another issue. They (Faryal and Siddiqui) argue that the corporate failures only happen in the presence of criminal intent and sadly, CCG has nothing to do with *mala fide*. By posing this argument, they are completely denying the significance of CCG. This thesis argues that, though failures occur due to criminal intent, but if companies follow CG principles in their true spirit recognising and believing on the benefits of compliance with CG principles, such *mala fide* will get no/less opportunity to

⁶² Methodology issue: the sample of interviewee is very short as it based on only one interview.

⁶³ Shareholdings being in the some hands for example in FOEs and SOEs

grow and consequently there will be no failures or at least their number will be reduced.

Mahwesh⁶⁴ attempted to investigate whether the Anglo-Saxon model of CG embraced by Pakistan, does in fact satisfy the necessity of being illustrative of the issues that are particular to Pakistan. She could not give any straightforward answer however; she highlighted the various variables, the communications of which structures the corporate system of any nation. The findings of this article are confusing to draw any conclusion that what the perspective Mahwesh has on her point. However, this researcher submits that whatever the model is, the basic principles of CG are same in every model. Therefore, the significant issue is to make their compliance better in order to get required results. As only 'law in books' would have no desirable consequences unless the 'law in action' work effectively.

Yaser and Safdar⁶⁵ conducted empirical research to find the impact of CG practices on the financial performance of companies in Pakistan. A sample of 50 non-financial companies was arbitrarily chosen, for the period ranging from 2003 to 2005. They concluded that, computing a governance score in this way is not entirely impartial. Many of the parameters like quality of narrative are very subjective in nature. One might get diverse score according to one's observation. Likewise, the outcome can be totally diverse by varying the weighting of these parameters. Secondly, the data was taken from annual reports, so researchers had to believe what was reported regardless of the actual situation. Therefore, they could not reach a clear conclusion regarding the influence of CG standards on financial performance of companies.

⁶⁴ Mahwesh Mumtaz, *Corporate Governance in Pakistan: Adopt or adapt?* (University of Cambridge 2005) "See generally"

⁶⁵ Yasir Tariq and Safdar Butt, 'Impact of Corporate Governance Practices on Financial Performance: Empirical Evidence from Pakistan' (2008) Conference Paper <<http://ssrn.com/abstract=1648547>> accessed 01 March 2015

Makki and Lodhi⁶⁶ determined the basic relationship in the middle of CG and economic performance. Their study presumed that CG does not enhance financial performance reliably. Maybe it can upgrade it altogether through misusing elusive assets. However, their study does not clarify that how it asserts that CG can enhance the financial performance of companies but does not improve consistently.

This researcher's opinion is that the improvement in financial performance depends upon the governance of companies; if a company follows CG principles consistently, its performance will also improve consistently, on the other hand, if a company does not follow CG rules and govern the company according to managers/directors own will neglecting shareholders rights, not disclosing their performance mechanisms properly in annual reports, not having an independent audit, such company will ultimately loose its trust and confidence; its performance cannot be improved but rather will collapse.

As discussed above, a large portion of the experimental work for investigating conceivable connections between CG and performance of companies has been attempted for advanced countries. For example, an extensive study was conducted for the US companies by Brown and Caylor⁶⁷ for the purpose of calculating the effect of CG on the outcome of those companies and they found that better represented companies are generally more beneficial, more significant and maximise the wealth of their shareholders.

This thesis argues that, the debate regarding the association in the middle of CG and companies' performance has been generally concentrated however come to no agreement. On the other hand, there is a generally held perspective that great CG practices are connected with better performance of companies.

⁶⁶ Muhammad Makki and Suleman Lodhi, 'Impact of Corporate Governance on Financial Performance' (2013) 33(2) Pakistan Journal of Social Sciences 265 267

⁶⁷ Lawrence Brown and Marcus Caylor, 'Corporate Governance and Firm Valuation' (2004) 25(4) Journal of Accounting and Public Policy 409, 412

There are additionally a few research works in which the impact of CG norms and companies' financial outcomes have been interrelated. A few studies have discovered this vital connection noteworthy⁶⁸ and some discovered it as inconsequential.⁶⁹ Several CG methods have additionally been demonstrated as having inverse connection.⁷⁰ Although, numerous studies demonstrate that CG is a performance booster and increases the value of a company.⁷¹ Indeed, even those studies which give uncertain results identified with CG and performance contend that CG has, no less than, an indirect impact on the performance of a company.⁷²

Bad corporate performance has additionally been dealt with as an outcome of poor CG. For instance Gompers *et al.*,⁷³ look at the association between CG standards and their impact on long haul equity values, company's esteem and financial performance. Their outcomes uncover that all around represented companies illustrate higher value returns, higher esteem and better financial outcomes when contrasted with their ineffectively administered partners.

Similarly, Drobetz *et al.*⁷⁴ located an affirmative association between CG norms and anticipated stock profit in the public companies of Germany. Brown and Caylor⁷⁵ assert that, the better administered companies are more beneficial, appreciate greater market esteem and maximise profits of their investors. Shaheen

⁶⁸ Benjamin Ehikioya, 'Corporate governance structure and firm performance in developing economies: evidence from Nigeria' (2009) 9(3) *Journal of Corporate Governance* 231; Marek Gruszczynski, 'Corporate Governance and Financial Performance of Companies in Poland' (2006) 12(2) *International Advances in Economic Research* 1; Drobetz *et al.*, 'Corporate Governance and Expected Stock Returns: Evidence From Germany' (2004) 10(2) *European Financial Management* 267; Gordon Gemmill and Dylan Thomas, 'The Impact of Corporate Governance on Closed-end Funds' (2006) 12(5) *European Financial Management* 725

⁶⁹ Azizah Abdullah and Michael Page, 'Corporate Governance and Corporate Performance: UK FTSE 350 Companies' (2009) *The Institute of Chartered Accountants of Scotland* <https://www.icas.com/_data/assets/pdf_file/0011/10604/69-Corporate-Governance-and-Corporate-Performance-UK-FTSE-350-Companies-ICAS.pdf> accessed 10 March 2015

⁷⁰ David Yermack, 'Higher Market Valuation of Companies with a Small boards of Directors' (1996) 40 *Journal of Financial Economics* 185

⁷¹ Ibid (n 68); Drobetz *et al.*, 'Corporate Governance and Firm Performance: Evidence from Germany' (2003) <<http://www.wvz.unibas.ch/cofi/publications/papers/2003/05-03.pdf>> accessed 26 October 2014

⁷² Gregory Maassen, *An International Comparison of Corporate Governance Models* (3rd edition, Spencer Stuart 2002) 29

⁷³ Gompers *et al.*, 'Corporate Governance and Equity Prices' (2003) 118 *Quarterly Journal of Economics* 107

⁷⁴ Ibid (n 68)

⁷⁵ Ibid (n 67) 409

and Nishat⁷⁶ investigated the association among CG and company performance. They additionally locate a constructive relationship between CG standards and company performance.

Che-Haat *et al.*,⁷⁷ when concentrating on transparency, CG and the impact of these standards on the outcomes of Malaysian companies by using ordered regression method on 73 ‘virtuous’ companies and 73 companies whose performance was weak and found that CG variables have a solid foreseeing force on the outcomes of company in Malaysia primarily because of the supervision of debt and foreign investment.

Javed and Iqbal⁷⁸ analysed the impact of CG on a company’s outcomes in Pakistan and concluded that not all components of CG upgrade the outcome of a company. They additionally concluded that great CG procedures unveil less generation and awful administration through transparent disclosure and transparency guidelines.

Furthermore, Ehikioya⁷⁹ directed research on CG mechanism and company performance in the light of listed companies of Nigerian Stock Exchange and reasoned that ownership convergence has optimistic influence on outcome and more than one relative in BODs demonstrated an antagonistic impact on company outcome.

Abdullah and Page⁸⁰ conducted a research on CG and performance, utilising information of FTSE 350 companies of the UK and discovered minute backing of a link between CG and performance. They contended that CG components clarify only limited discrepancy in risk attributes.

⁷⁶ Rozina Shaheen and Mohammad Nishat, ‘Corporate Governance and Firm Performance in an Emerging Market – An Exploratory Analysis of Pakistan’ (2007) 4(2) Journal of Corporate Ownership and Control 216

⁷⁷ Che – Haat *et al.*, ‘Transparency and Performance of Malaysian Companies’ (2008) 23(8) Management Auditing Journal 744

⁷⁸ Attiya Javed and Robina Iqbal, ‘Corporate Governance and Firm Performance: Evidence from Karachi Stock Exchange’ (2006) 45(4) The Pakistan Development Review 947

⁷⁹ Ibid (n 68)

⁸⁰ Ibid (n 69)

However Sueyoshi *et al.*⁸¹ advocated a novel observational confirmation that CG modifications by the government of Japan have had an impact on the outcomes of Japanese companies. They demonstrated that remote investors encourage administrative discipline and knowledge which eventually upgrade the performance of Japanese companies.

Bauer *et al.*,⁸² while contemplating the effect of CG on Real Estate Investment Trusts (REIT) and their outcome discover that CG Quotient Index (CGQ index) is neither identified with REIT esteem nor to any of the three operational methods of performance, though REIT with more prominent instruments demonstrate an association between CGQ index and outcome of REIT.

Similarly, Aboagye and Otieku⁸³ examined the connection between CG of small companies and their performance. They find no relationship between classification taking into account CG and classification in view of financial performance.

Renders *et al.*,⁸⁴ discover a noteworthy positive association between CG evaluations and outcome in a Cross-European study comprising on fourteen states in the wake of directing sample selection bias. Moreover, the quality of this association appears to rely upon the nature of the institutional environment. Similarly, Reddy *et al.*⁸⁵ conducted a study by applying normal least squares and two stages least squares regression procedures to analyse the effect of New Zealand Securities Commission's standards of CG on company performance.

⁸¹ Sueyoshi *et al.*, 'Corporate Governance and Firm Performance: Evidence From Japanese manufacturing Industries After the Lost Decade' (2010) 2(3) European Journal of Operational Research 724, 735

⁸² Bauer *et al.*, 'Corporate Governance and Performance: The REIT Effect' (2010) 38(1) Real Estate Economics 1; Bauer *et al.*, 'Empirical Evidence on Corporate Governance in Europe: The Effect on Stock Returns, Firm Value and Performance' (2004) 5(2) Journal of Asset Management 91

⁸³ Anthony Aboagye and James Otieku, 'Are Ghanaian MFI's Performance Associated with Corporate Governance' (2010) 10(3) Corporate Governance 307

⁸⁴ Renders *et al.*, 'Corporate Governance Ratings and Company Performance: A Cross-European Study' (2010) 18(2) Corporate Governance: An International Review 87

⁸⁵ Reddy *et al.*, 'The Efficacy of Principle-Based Corporate Governance Practices and Firm Financial performance: An Empirical Investigation' (2010) 6(3) International Journal of Managerial Finance 190

Their study established that these CG standards have a constructive impact on company outcomes.

In short, it can be concluded that, although the opinions are mixed about the relationship of CG and company's performance, as few researches discover a substantial influence of CG on financial performance,⁸⁶ while others demonstrate no such association.⁸⁷ These diverse outcomes invite the academics to examine further the part of CG and its impact on financial performance. However, all studies accept the importance of CG and its positive effect on companies' performance in one or other way. Indeed, even those studies which give uncertain outcomes contend that CG has at any rate backhanded impact on performance.

These results validate the significance of this thesis confirming the importance and impact of CG principles on the performance of companies which ultimately affect the economy of a country.

2.4.2 Pakistan's Ownership Structure and Corporate Governance

There is an extensive assortment of experimental exploration that has evaluated the impact of CG on company performance for the advanced markets (as stated earlier).⁸⁸ These researches have demonstrated that great administration practices have driven the noteworthy growth in the financial performance of companies, higher profitability and less danger of precise economic disaster for states.

The studies conducted by Shleifer and Vishny⁸⁹ and Hermalin and Weisbach⁹⁰ provide a great deal of literature review about the impact of good CG practices on

⁸⁶ Ibid (n 68); Carlos Alves and Victor Mendes, 'Corporate Governance Policy and Company Performance: the Portuguese Case' (2004) 12(3) *Corporate Governance: An International Review* 290; David Yermack (ibid n 70)

⁸⁷ Ibid (n 69)

⁸⁸ Ronald Anderson and David Reeb, 'Board Composition: Balancing Family Influence in S & P 500 Firms' (2004) 49 *Administrative Science Quarterly* 209; Bernard Black and Vikramaditya Khanna, 'Can Corporate Governance Reforms Increase Firms' Market Values? Event Study Evidence from India' (2007) 4(4) *Journal of Empirical Legal Studies* 749; Drobetz *et al.* (ibid 68); Durnev A and Kim H, 'To Steal or Not to Steal: Firm Attributes, Legal Environment and valuation' (2005) 60(3) *Journal of Finance* 1461; Gompers *et al.* (ibid 73)

⁸⁹ Andrei Shleifer and Robert Vishny, 'A Survey of Corporate Governance' (1997) 52 *Journal of Finance* 737

the company's performance. It has now turned into an essential region of exploration in developing markets too.⁹¹

Clarke⁹² condemned CG mechanisms in Asia. His condemnation concentrated on the Asian corporate scandals, which was created by weak CG standards. Ali⁹³ attests that, not at all like the Berle and Means model of division of possession and control, Pakistan's prevailing corporate ownership structure takes after a concentrated family possession structure. Mainstream investors hold control of a company as well as are occupied with its administration. As a result of Pakistan's common law foundation, the state's legal framework takes after the Anglo-Saxon model; on the other hand, the ownership structure of Pakistan is the inverse of the Anglo-Saxon structure of dispersed ownership which is a clear mismatch.

This thesis asserts that Pakistan's model of CG should be devised according to its needs of concentrated types of shareholdings. For instance, instead of following any particular model of a country or converging the characteristics of other countries' models; if Pakistani listed companies start following only the basic principles of CG such as, transparency, disclosure, fairness, independence and accountability, the picture of Pakistan's CG mechanism will be changed automatically.

However, the CCG of Pakistan overlooks this difference and advantages from the UK and South African reform activities. Therefore, following the enforcement of the CCG 2002, hesitant companies consider the usage of new administration not only costly to implement as well as essentially hard to execute. Whereas on one hand there is an administrative weight to uphold the CCG, on the other, there is a

⁹⁰ Benjamin Hermalin and Michael Weisbach, 'Boards of Directors as an Endogenously Determined Institutions: A Survey of the Economic Literature' (2003) 9(1) Economic Policy Review 7

⁹¹ Leora Klapper and Inessa Love, 'Corporate Governance, Investor Protection and Performance in Emerging Markets' (2004) 10 Journal of Corporate Finance 703; Javid and Iqbal (ibid 78); Mir and Nishat (ibid 76)

⁹² Ibid 11

⁹³ Ali Ibrahim, 'Corporate Governance in Pakistan: Analysis of Current Challenges and Recommendations for Future Reforms' (2006) 5 Washington University Global Studies Law Review 323

conceded absence of important aptitude that can help with the implementation of the quintessence of CG in Pakistan.

Ali⁹⁴ takes after the recommendation of Khalil⁹⁵ that, the non-compliance ought to be entirely followed during the procedure of the “comply or explain” rule. As needs be the companies ought to be rigorously required to guarantee compliance with their ‘Statement of Ethics and Business Practices’ in addition to the presence of such an explanation. In such manner, SECP ought to give a common example establishing the basic substance for ‘Statement of Ethics and Business Practices’ and moreover, necessitate the companies to extend their own particular Statement on the premise thereof.

Javid and Iqbal⁹⁶ investigated the CG issues in the equity market of Pakistan, its repercussions for corporate valuation, corporate financing and corporate ownership. To measure the company’s governance level they utilise a rating framework to assess the rigour of an arrangement of administration norms and cover different governance types, for example, board composition, possession, shareholdings, transparency, disclosure and auditing.

However, their findings cannot be generalised as they used the model of 60 non-financial companies listed on the Karachi Stock Exchange (KSE). The findings of this sample does not depict the situation of financial companies, secondly, it is also not clear which rating framework they utilised to assess the rigour of administration practices. Javid and Iqbal⁹⁷ utilised information from yearly reports for 2003 to 2006 to assess elements of CG. Therefore, the results generated from that data may not be completely reliable as the annual reports of Pakistani companies are usually published merely to fulfil a requirement.⁹⁸

⁹⁴ Ibid (n 93)

⁹⁵ Khalil Ahmad, ‘Short-Comings in Corporate Governance Code’ (2004) 7(8) The Business Recorder Islamabad

⁹⁶ Ibid (n 78)

⁹⁷ Attiya Javid and Robina Iqbal, ‘External Financial Resource Management by Listed Pakistani Firms’ (2007) 46(4) The Pakistan Development Review “See generally”

⁹⁸ The researcher of this thesis.

Moreover, Ashraf and Ghani⁹⁹ examined the business community and their effect on CG in Pakistan for non-financial companies recorded on the KSE of Pakistan for 1998-2002. Their confirmation demonstrates that shareholders see the business community as an instrument to seize individual investor or minority shareholders. Then again, the proportional financial performance outcomes propose that business groups in Pakistan are effective financial game plans that replace for missing or wasteful external organisations and markets.

In any case, the study by Cheema *et al.*¹⁰⁰ proposed that CG can play an important role for Pakistan to draw in foreign direct investment (FDI) and accumulate more noticeable investment funds via capital provided the CG structure is perfect with the objective of floating external equity capital via capital markets. The corporate framework of Pakistan is described as concentrated with family control, pyramid structures, cross-shareholding and interlocking directorships. The worry is that reforms whose fundamental target is to safeguard investors' interests may reduce profit increasing motivations for families without giving balanced advantages through the method of equally proficient monitoring by individual investors. In the event that this occurs, the reform may wind up making imperfect motivations for enhancing the profits by families.

They contend that a critical test for regulators is to enhance the double purposes of individual investor security and the preservation of profit enhancing motivating forces for family administrators. This researcher submits that, there is a requirement for progressive and dynamic companies to take initiative in struggles for reform in CG too. As the PICG taking initiatives to increase awareness among general public and business community regarding the advantages attached to the compliance with CG principles.

If the family owners realise that adopting CG principles would enhance the growth of their business which is ultimately in their benefit, the interests of

⁹⁹ Junaid Ashraf and Waqar Ghani, 'Accounting Development in Pakistan' (2005) 40 The International Journal of Accounting 175, 201

¹⁰⁰ Cheema *et al.*, 'Corporate Governance in Pakistan: Ownership, Control and the Law' (2003) University of Management Sciences Lahore

minority shareholders would also be protected. This issue is addressed by this thesis in two ways: via splitting the stock market into segments (see section 5.5.2) and secondly IIs can also play their role in this. Moreover, the example of multinational companies based in Pakistan can also serve the purpose, as multinational companies are more incline to adopt CG principles and they are earning profits more than any other company listed on KSE.

Rais and Saeed¹⁰¹ examined Pakistan's CCG 2002 from the perspective of Regulatory Impact Assessment (RIA) system and its authorisation and implementation in Pakistan with a specific end goal to understand the progress of community decision making and evaluate the viability of the regulation strategy of SECP in the enclosure of CG. Their investigation demonstrates that however the listed companies are outfitting themselves to embrace the CCG; there are a few requirements and objections regarding its drafting and application. They argue that the use of RIA has not been considered while formulating the CCG. However, SECP claims that all necessary requirements were fulfilled and required steps were followed in order to formulate a good CCG, but the opinion of stakeholders and listed companies rebut this stance of SECP.

This observation is consistent with one of the objectives of this thesis; to assess and identify the weaknesses of CCG of Pakistan and explore the measures to improve them, as Pakistan's CCG is not drafted in a proper way keeping in mind the key realities of Pakistani corporate culture but rather converged from foreign Codes (as discussed above). It is important to mention here that the objective is not to evaluate the RIA of CCG rather its substance, weak and overlapping provisions.

Mir and Nishat¹⁰² and Shaheen and Nishat¹⁰³ investigated rating of CG in view of yearly reports and survey information correspondingly for the year 2004 and

¹⁰¹ Rasul Rais and Asif Saeed, 'Regulatory Impact Assessment of SECP's Corporate governance Code in Pakistan' (2005) CMER Working Paper 06-39 LUMS <www.secp.gov.pk> accessed 20 February 2015

¹⁰² Mir Shahid and Mohammad Nishat, 'Corporate Governance Structure and Firm Performance in Pakistan: An Empirical Study' (2004) Paper presented at Annual Conference on Corporate Governance at LUMS

associate this administration score with company's esteem. Every one of these studies arrives at the assumption that better governance practices expand the company's esteem.

The SECP, PICG and International Finance Corporation (IFC), conducted a survey identifying awareness with regards to CG for the year 2006. A significant expanding interest was noticed in examining the influence of CG on the stock market in Pakistan but several matters here remained unidentified. Specifically, company-level CG and its impact on the corporate ownership, corporate financing and corporate valuation are vital concerns around there which require inside and out investigation.

2.4.3 Compliance and Enforcement of Corporate Laws

This section analyses the studies focussing on the importance of the enforcement of corporate laws and CG principles which will also validate the significance of this research. The existent literature supports this researcher's view that strong enforcement mechanisms are necessary in order to obtain the required results from corporate law and CCG.

The idea of actual enforcement as opposed to simply the procurement of the law in books is not novel in theory.¹⁰⁴ Enriques¹⁰⁵ argues that, the application of law is imperative in a time of globalisation and competition where foreign investment has been expanded. This marvel identifies the significance for both local investors as well as to draw in foreign investors. Therefore, this research focuses on the role of the courts and capital market as enforcer of corporate laws.

This researcher states that the general courts in Pakistan are the principal forum for the enforcement and protection of rights; but, they have neglected to solve

¹⁰³ Shaheen Rozina and Mohammad Nishat, 'Corporate Governance and Firm Performance: An Exploratory Analysis' (2005) Conference Paper LUMS
<http://www.researchgate.net/publication/228628660_Corporate_Governance_and_Firm_Performance-An_Exploratory_Analysis> accessed 20 February 2015

¹⁰⁴ Roscoe Pound, 'Law in Books and Law in Action' (1910) 44 American Law Review 12

¹⁰⁵ Luca Enriques, 'Do Corporate Law Judges Matter? Some Evidence From Milan' (2002) 3(4) European Business Organisation Law Review 756, 812

corporate issues by effectively implementing the corporate law. Consequently, it is required to reform the judiciary and improve its capacity for the proper enforcement of laws. Secondly, the capital market of a country assumes a viable part in the execution of corporate law, but sadly, Pakistan's capital market could not succeed to carry out this obligation.

A few steps were attempted by the state in this regard, for example the establishment of PICG with the collaboration of IFC in order to enhance the awareness regarding the advantages of CG principles (as discussed above); the steps were also taken to enhance the judicial capacity.¹⁰⁶ Nonetheless they could not yield required results because of the personal stakes of individuals who did not appreciate even partial change.¹⁰⁷ Hence, it is required to modify Pakistan's capital market according to the business environment of the country.

Berglof and Claessens¹⁰⁸ argue that, in the initial stage of reform, the formulation of strong laws is essential regardless of the fact that there is a weak enforcement framework. The law in action can be guaranteed in the second stage of reform, by upgrading institutional aptitude. In this way, countries should enhance their enforcement frameworks for the purpose of making laws operative.¹⁰⁹

Hence, it is submitted that even the best laws in books without their effective implementation and enforcement mechanism cannot be productive. An effective machinery to implement the laws in true spirit is inevitable for the development of CG norms, the protection of shareholders' interest and the company performance which ultimately leads to the improvement in the economy of country.

¹⁰⁶ The initiatives taken to reform the judiciary in Pakistan are investigated in chapter five (see section 5.4).

¹⁰⁷ Such groups are identified above and also mentioned in chapter five (see section 5.3)

¹⁰⁸ Erik Berglof and Stijn Claessens, 'Enforcement and Corporate Governance' (2004) World Bank Policy Research Working Paper 3409, 41

<http://papers.ssrn.com/so13/papers.cfm?abstract_id=625286> accessed 20-02-2015

¹⁰⁹ Robert Cooter, 'Expressive Law and Economics' (1998) 27 Journal of Legal Studies 585, 606

Wymeersch¹¹⁰ wrote about the enforcement of CCG. He also argues that the implementation primarily happens through market structures, including by investors utilising their lawful and genuine rights inside the company. Likewise, LLSV¹¹¹ argued that the security of shareholders is pertinent for the growth of a market and CG standards. They further highlighted that the enforcement framework can be improved and operative in the presence of good laws and vice versa.

Ashraf and Ghani¹¹² examined the inceptions, development and improvement of financial and disclosures practices in Pakistan and the elements that affected them. They archive that an absence of shareholders' security, judicial inefficiency, and frail implementation frameworks are more basic variables in contrast to social components in clarifying the economic condition in Pakistan. They reason that the implementation framework is foremost in enhancing the nature of economic conditions in emerging countries.

Haris¹¹³ wrote about the development of CG in Pakistan. He also declared the FOEs as an important factor responsible for the unsuccessful implementation of CCG. He put the responsibility of Pakistan's weak CG mechanism on inactive and irresponsible financial press as well.

Moving further, Simon¹¹⁴ asserts that there are three key advantages of a CCG versus mandatory approach to regulate CG: knowledge dissemination, flexibility of corporate practice and transparency. This is a descriptive study shedding light on the pros and cons of developing and implementing CCG. He asserts that voluntary CCG have been employed increasingly across the globe to derive CG

¹¹⁰ Eddy Wymeersch, 'Corporate Governance Code and their Implementation' (2006) Working Paper Series 2006-10 Financial Law Institute <<http://ssrn.com/abstract=931100>> accessed 1 May 2015

¹¹¹ LLSV, 'Legal Determinants of External Finance' (1997) 52(3) The Journal of Finance 1131; LLSV, 'Law and Finance' (1998) 106(6) Journal of Political Economy 1113

¹¹² Ibid (n 99)

¹¹³ Haris Ahmad, 'Myth of Corporate Governance in Pakistan' (2009) Daily English National Newspaper

¹¹⁴ Simon Wong, 'Developing and Implementing Corporate Governance Codes' (2008) Public sector Opinion, Issue 10, A Global Corporate Governance Forum Publication International Finance Corporation <<http://ssrn.com/abstract=1321127>> accessed 1 December 2014

reforms. However, the challenge lies in ensuring their effective implementation and enforcement.

Notwithstanding, this researcher submits that it is not the voluntary or mandatory nature of laws that matter it is the effective implementation and enforcement that matters. Moreover, the nature of law whether it should be hard law or soft law also depends upon other factors; such as in Pakistan voluntary provision of law cannot work effectively, at least, in current scenario when the corporate sector is in transition stage. Therefore, this thesis advocates that the CCG formulated with the combination of both voluntary and mandatory provisions will make them more effective for the corporate market of Pakistan.¹¹⁵ The hard law approach can also curb the criminal intent which leads to corporate failure as proclaimed by Faryal and Kamran (mentioned above).

2.4.4 Role of Board of Directors (BODs) in Promoting CG Best Practices

This section provides the literature review regarding the significance of effective BODs, followed by variables which make the boards effective such as, size, composition, diversity and independence of BODs. As one of the objectives of this thesis is to formulate a board effectiveness model for the listed companies of Pakistan, the prior studies discussed and analysed in this section validate the significance of the objective of this thesis in a way that this topic is worth investigating with reference to Pakistan.

The BODs is the uppermost body of a company that is in charge of dealing with company and its procedure. It assumes key part in policy decisions concerning financial blend. Pfeffer and Salancik¹¹⁶ locate a critical association between size of BODs and capital framework. The proof with respect to bearing of connection between size of BODs and capital framework is diverse. Berger *et al.*¹¹⁷ discover

¹¹⁵ The detail discussion and arguments regarding hard law and soft law are provided in chapter five (see section 5.3 sub section IIs)

¹¹⁶ Jeffrey Pfeffer and Gerald Salancik, *The External Control of Organisations: A Resource Dependence Perspective* (Harper and Row 1978) 16

¹¹⁷ Allen Berger *et al.*, 'Executive Board Composition and Bank Risk Taking' (2012) 38 <<https://www.econstor.eu/bitstream/10419/56024/1/688561233.pdf> accessed 20 December 2015>;

that companies having large BODs for the most part have poor outfitting levels. They contend that large BODs apply weight on managers to take after poorer outfitting levels and improve company's performance. However, this thesis takes the stance that smaller BODs are better and more effective than larger BODs (see section 6.3).

Abor¹¹⁸ examines the association in the middle of CG and capital framework choices of Ghanaian Small and Medium Enterprises (SMEs) by utilising multivariate relapse investigation. His outcomes give proof about adverse connection between size of BODs and influence proportions and SMEs with large BODs for the most part have poor level of equipping.

Then again, Wen *et al.*,¹¹⁹ identify an affirmative association between BODs size and capital edifice of a company. They content that extensive size of BODs take after a strategy of more elevated amounts of adapting to upgrade company's esteem particularly when these are settled because of more prominent checking by regulatory authorities. They likewise contended that large BODs may face trouble in landing at an agreement in decision-making which can eventually influence the nature of CG and will convert into higher financial influence levels.

Jensen¹²⁰ asserts that, companies with high adapting level have large BODs. Anderson *et al.*,¹²¹ identify that the expense of obligation is by and large lower for large BODs in light of the fact that banks believe that these companies are being controlled all the more viably by an expanded arrangement of specialists. So debt financing turns into a cost effective decision.

Allen Berger and Loretta Mester, 'Inside the Black Box: What Explains Differences in the Efficiencies of Financial Institutions?' (1997) 21 Journal of Banking and Finance 97

¹¹⁸ Joshua Abor, 'Corporate Governance and Financing Decisions of Ghanaian Listed Firms' (2007) 7(1) Corporate Governance 83

¹¹⁹ Wen *et al.*, 'Corporate Governance and Capital Structure Decisions of the Chinese Listed Firms' (2002) 10(2) Corporate Governance: An International Review 75

¹²⁰ Michael Jensen, 'Agency Costs of Free Cash Flow, Corporate Finance and Takeovers' (1986) 76(2) American Economic Review 323

¹²¹ Anderson *et al.*, 'Board Characteristics, Accounting Report Integrity, and the Cost of Debt' (2004) 37 Journal of Accounting and Economics 315

Much empirical research has been carried out on the composition of BODs and its impact on company performance. The existence of NEDs on BODs of a company signals to the business sector that company is being checked proficiently so loan specialists consider the company more credit commendable. Resultantly, this makes it less demanding for the company to promote long haul reserves through debt financing. It is speculated that higher representation of NEDs on BODs prompts higher adapting levels. The structure of BODs speaks to the extent of NEDs on BODs and is computed as the quantity of NEDs separated by aggregate number of executives.¹²²

Zulfiqar and Safdar¹²³ conducted a study to examine the effect of the nature of CG, as determined by a uniquely built CG record, on the normal expense of equity figured utilising the Capital Asset Pricing Model (CAPM). An aggregate of 114 listed companies were inspected to examine the link between two attributes for the period 2003 to 2007. They utilised expressive measurements, a relationship network, a basic ordinary least squares (OLS), and settled impact model to examine the board information gathered. They discovered an inverse connexion between the size of BODs and managerial ownership with the expense of value, and an affirmative connexion between independence of BODs, audit committee autonomy, and CG with the expense of equity. These outcomes could be because of the move stage under which the corporate sector of Pakistan is passing through after the declaration of the CCG in 2002.

Conversely, Sunday-O¹²⁴ directed a research on CG and the performance of companies utilising twenty listed companies of Nigeria somewhere around 2000 and 2006. Utilising panel methodology as a strategy for assessment, the outcomes

¹²² Barry Baysinger and Henry Butler, 'Corporate Governance and Board of Directors: Performance Effects of Changes in Board Composition' (1985) 1 Journal of Law, Economics and Organisation 101; Barry Baysinger and Hookisson RE, 'The Composition of Boards of Directors: Performance Effects of Changes in Board Composition' (1990) 1 Journal of Law, Economics and Organisation 101

¹²³ Zulfiqar Shah and Safdar Butt, 'The Impact of Corporate Governance on the Cost of Equity: Empirical Evidence From the Pakistani Listed Companies' (2009) 14(1) Lahore Journal of Economics 139

¹²⁴ Sunday-O Kajola, 'Corporate Governance and Firm Performance: The Case of Nigerian Listed Firms' (2008) 14 Journal of Economics, Finance and Administrative Sciences 16

were diverse; CEO dichotomy and size of BODs were critical however composition of BODs and audit committee were irrelevant.

Azeem *et al.*,¹²⁵ tried to find CG scores figured by receiving a record from prior studies. Their study highlighted that BODs and audit committees are not as free as a decent CG society would request or expect. One purpose behind this could be that the data are tilted in the direction of turning area, in which the number of FOEs is higher. Another explanation behind this situation is the non-appearance of an unmistakable meaning of INEDs in Pakistan. Companies are motivated to mark all NEDs as free voluntarily.

This researcher believes that there is a prompt requirement for CCG to think of an exact and enforceable meaning of INEDs, and for controllers to guarantee that it is legitimately taken after. With the rise of genuinely autonomous directors, who act not for a specific stakeholder but rather for the combined benefits of all stakeholders, companies will turn out to be more transparent in their verdicts. Resultantly, this ought to prompt better CG and more prominent investor trust in listed companies.¹²⁶

Furthermore, Gill *et al.*,¹²⁷ find that one of the governance mechanisms, being increased reporting or disclosure, has a positive relationship with improved company performance. A central CG question is whether and to what extent, does the BODs matter in the governance or directing and controlling of the company. Qiu and Largay¹²⁸ find an affirmative association between the activities of BODs and company's upgraded esteem.

¹²⁵ Azeem *et al.*, 'Impact of Quality Corporate Governance on Firm Performance: A Ten Year Perspective' (2013) 7(3) Pakistan Journal of Commerce and Social Sciences 656

¹²⁶ For the detailed investigation of this view see section 6.4.

¹²⁷ Gill *et al.*, 'Corporate Governance Mechanisms and Firm Performance: A Survey of the Literature' (2009) 8(1) IUP Journal of Corporate Governance 7

¹²⁸ Xiaodong Qiu and James Largay, 'Do Active Board of Directors Add Value to Their Firms?' (2011) 25(1) The Academy of Management Perspectives 98, 99

However, Arshad and Safdar¹²⁹ explored the relationship between CG and capital framework of listed companies in Pakistan. Their research covers the period 2002 to 2005 for which company level information for 58 haphazardly chose non-financial listed companies from KSE. Consequences of their study uncover that the size of BODs and managerial shareholding is contrarily associated with obligation to equity proportion. Though, corporate financing behaviour is not discovered essentially affected by CEO duality and the existence of NEDs on the BODs. In this manner, outcomes propose that CG variables like ownership structure, size and administrative shareholding assume an essential part in the investigation of the financial blend of companies.

Moving further, the relationship between the presence of NEDs and capital framework has been investigated. Pfeffer and Salancik¹³⁰ accentuate that NEDs assumes a significant part in improving the ability of a company to obtain acknowledgment from outside stakeholders. This prompts decrease in instability about the company and improves the capacity of the company to raise reserves. They find that a larger representation of NEDs on BODs prompts higher performance levels.

Jensen¹³¹ and Berger¹³² identify that companies with better performing levels have generally more NEDs while companies with less number of NEDs practice less influence. Abor¹³³ additionally give proof about the existence of a positive association among adapting levels and CEO duality, composition and skills of BODs.

Then again academics such as Wen *et al.*,¹³⁴ provide proof about the presence of a fundamentally adverse link between financial position of a company and presence of NEDs on BODs. The probable cause is that NEDs monitor the administrators

¹²⁹ Safdar Butt and Arshad Hasan, 'Impact of Ownership Structure and Corporate Governance on Capital Structure of Pakistani Listed Companies' (2009) 4(2) International Journal of Business and Management 50

¹³⁰ Ibid (n 116) 16

¹³¹ Ibid (n 121) 325

¹³² Ibid (n 117) 98

¹³³ Ibid (n 118) 84

¹³⁴ Ibid (n 119) 76

for all the more proficiently and successfully so directors are compelled to look for lower intending levels for getting prevalent outcomes. Thus companies having BODs dominated by NEDs are sure to take after low financial influence with a high market estimation of equity. It is normal that restricting the size of BODs is to increase company performance in the light of the fact that the advantages of large BODs results into expanded monitoring by the weak correspondence and decision-making of bigger groups.¹³⁵

The study by Yermack¹³⁶ gives an opposite connection between the size of BODs, cost-effectiveness and resource use. Anderson *et al.*,¹³⁷ arrives at an inference that the cost of debt is lesser for large BODs, on the grounds that creditors trust these companies are having more viable controllers of their financial accounting procedures. Brown and Caylor¹³⁸ identify those companies with sizes BODs of anywhere about six and fifteen have greater returns for value and greater net profit margins than companies with other sizes of BODs.

The connection between the extent of external directors, an intermediary for impartiality of BODs, and company performance is uncertain. Weisbach¹³⁹ and Bhagat and Black¹⁴⁰ discover no connection between the extent of external directors and different performance procedures. However, Baysinger and Butler¹⁴¹ and Rosenstein and Wyatt¹⁴² demonstrate that the business sector appreciates companies for employing external directors.

¹³⁵ Martin Lipton and Jay Lorsch, 'A Modest Proposal for Improved Corporate Governance' (1992) 48(1) Business Lawyer 59, 77; Michael Jensen, 'The Modern Industrial Revolution, Exit and the Failure of Internal Control Systems' (1993) 48(3) Journal of Finance 831, 832

¹³⁶ Ibid (n 70) 185

¹³⁷ Anderson *et al.*, 'The Evolution of Corporate Governance: Power Redistribution Brings Boards to Life' (2007) 15(5) Corporate Governance: An International Review 780

¹³⁸ Ibid (n 67) 413

¹³⁹ Michael Weisbach, 'Outside Directors and CEO Turnover' (1988) 20 Journal of Financial Economics 431, 432

¹⁴⁰ Sanjai Bhagat and Brian Black., 'The Non-Correlation Between Board Independence and Long-Term Firm Performance' (2002) 27 Journal of Corporation Law 231

¹⁴¹ Ibid (122) 103

¹⁴² Stuart Rosenstein and Jeffrey Wyatt, 'Outside Directors, Board Independence and Shareholder Wealth' (1990) 26 Journal of Financial Economics 175, 180

Brickley *et al.*,¹⁴³ locate a constructive connection between the extent of external directors and the business sector response to ‘poison pill’ implementations. Anderson *et al.*,¹⁴⁴ demonstrate that the expense of obligation is conversely identified with the autonomy of BODs. The researches that utilise financial statement information discover no relationship between the independence of BODs and company’s performance, whereas those utilising stock profits data or bond yield data locate an affirmative connection.¹⁴⁵

Brown and Caylor¹⁴⁶ do not find any growth in the autonomy of BODs, yet they do find that companies with autonomous BODs have greater return limitations, greater returns on equity, higher stock trading, higher dividend yields and proposing that independence of BODs is connected with other essential ways of firm performance.

The outcomes of existing studies (both theoretical and empirical) discussed in this section show the differing opinions regarding the size, composition and independence of BODs. However, these studies confirm that these variables have considerable impact on the effectiveness of BODs. Therefore, this section approve that the variables (size, composition and independence of BODs) selected in this thesis to examine the effectiveness of BODs and formulating the board effectiveness model for Pakistani listed companies is purely valid; apart from the discussion that whether larger or smaller BODs are more effective, more independent or less independent BODs are more effective; the BODs with more executive or more NEDs are more effective which has been analysed and concluded with valid arguments in chapter six (see sections 6.3 to 6.5)

¹⁴³ Brickley *et al.*, ‘Corporate Leadership Structure: On the Separation of the Positions of CEO and Chairman of the Board’ (1997) 3 Journal of Corporate Finance 189

¹⁴⁴ Ibid (n 88) 210

¹⁴⁵ Ibid (n 88); Sanjai Bhagat and Brian Bolton, ‘Corporate Governance and Firm Performance’ (2008) 14 Journal of Corporate Finance 257

¹⁴⁶ Ibid (n 67) 414

2.4.5 The Role of Institutional Investors in Corporate Governance

This section reviews the literature on IIs, their increasing importance and role in the contemporary corporate world. As it is one of the objectives of this thesis to explore the role of IIs in promoting CG practices in Pakistan,¹⁴⁷ the literature review of this section establishes the worth of this objective and validates the reasoning of this study for investigating this topic.

Chris Mallin¹⁴⁸ claims that IIs are associations who collect money from people and companies. They put money as significant players in the stock market utilising proficient administration and work inside the limitations set by their own rules and contractual obligations and in addition tax and legitimate contemplations. Their objective is to boost the profits on investments and reduce the probability of risk appended to the shares of individual companies.

Dhaliwal Spinder¹⁴⁹ claims that, keeping in mind the end goal to draw in more finances and grow existing ones IIs have to make investments which will not be negative to their reputation of being harmless and trustworthy. Thus they have a tendency to abstain from putting resources in small companies and new projects. They additionally tend to restrain the most extreme size of any holding in light of the fact that the bigger size the more troublesome it is to discard the shares notwithstanding poor performance. Their technique is by and large to investigate the past performance of companies and to put resources into large, steady, effective and successful companies.

Mike Strivens¹⁵⁰ conducted a study on the influence of institutional shareholding in CG of the UK companies'. He finds that institutional shareholding is estimated as percentage of shares seized by institutions (institutional investors (IIs)) as disclosed in annual financial reports. The existence of institutional shareholding in

¹⁴⁷ Chapter seven investigates this.

¹⁴⁸ Chris Mallin, 'Trustees, Institutional Investors and Ultimate Beneficiaries' (2004) 12 (3) *Corporate Governance: An International Review* 239, 240

¹⁴⁹ Spinder Dhaliwal, 'The Role of Institutional Investors in the UK Economy' (PhD thesis, University of Brunel 1992)

¹⁵⁰ Mike Strivens, 'The Influence of Institutional Shareholdings in Corporate Governance of UK Firms' (PhD thesis, University of Manchester 2006)

a company leads it to collect long haul money at a valuable cost. In any case, institutional shareholders themselves go about as a wellspring of long haul debt as they are willing to give debt to a company over whose BODs they have an impact.

Furthermore, IIs serve as a powerful monitoring gadget over the company's policy decisions. They cut down company's agency expenses furthermore lessen administrative advantage. This offers certainty to the overall population and different loan specialists; bringing about ideal terms of getting for the company. It is in this manner estimated that companies with higher institutional shareholding are liable to have a higher debt to equity proportion.¹⁵¹

Contemporary studies on CG additionally give careful consideration to the matter of investors' character. It focuses on that the target capacities and the expense of practicing control over directors change considerably for distinctive sorts of owners. The repercussion is that it makes a difference not the amount of value a shareholder claims, but rather additionally the identity of shareholder; whether a family, a private individual, labourer, director, money foreign enterprise or financial institution.¹⁵²

The potential influence of large shareholders in the UK was recognised by Berle and Means in the 1930s, when they highlighted the departure of ownership and control of the companies, because of the fact that the managers were having all controlling authorities.¹⁵³ This partition prompts the issue connected with agency theory. However, all through the 20th century, the ownership arrangement kept on changing and the individual ownership weakened and institutional share ownership expanded.¹⁵⁴

After Berle and Means, Prais¹⁵⁵ firstly attracted attention, regarding the part of IIs in the advancement of large companies in the UK. The ramifications of the growth

¹⁵¹ Ibid (n 150)

¹⁵² Ibid (n 150)

¹⁵³ Berle and Means (ibid 13)

¹⁵⁴ Christine Mallin, *Corporate Governance* (4th edition, Oxford University Press 2013) 104

¹⁵⁵ Sigbert Prais, *The Evolution of Giant Firms in Britain* (Oxford University Press 1976) "See generally"

of these mediators are that their possession of the larger part of UK normal stocks prompted an apprehension of convergence of economic control over industry. The others also shared this apprehension. The then Governor of the Bank of England¹⁵⁶ noticed the developing convergence of stocks in the influences of the IIs.

Briston and Dobbins¹⁵⁷ had already acknowledged the development of IIs and investigated their imaginable effect upon the Stock Exchange, investors and corporate controlling. They evidenced that institutional shareholdings grow with time in all types of company.¹⁵⁸ Rutterford¹⁵⁹ expressed that their existence was presently so conspicuous that each aspect of investment is influenced by their presence. Their investment procedures, policies and performance have expansive outcomes.

In 1980 the Wilson Report¹⁶⁰ was established to examine the role of IIs in the UK. The report identified the primary issues raised by the IIs. The fundamental focuses were: the absence of accountability of IIs; their investment techniques and policies (British industry and accordingly the economy all in all was enduring in light of the fact that IIs were contributing wholes abroad); new and small companies were being famished of method of finance as IIs favoured putting resources into huge, well-settled companies; they were likewise blamed for short-termism administering to their benefits with a specific end goal to go after custom.

This issue was also highlighted later by Spinder¹⁶¹ in 1992 (as discussed above), that IIs avoid investing in small and new ventures and prefer to make investments in large well-settled companies. Spinder further identify the reason of this act or strategy of IIs that, purpose of IIs' investment is to maximise the profits of their

¹⁵⁶ Governor of the Bank of England, 'Speech at the investment conference of the National Association of Pension Funds' (1984) 24 Bank of England Quarterly Bulletin

¹⁵⁷ Richard Briston and Richard Dobbins, 'The Growth and Impact of Institutional Investors' (1978) Institute of Chartered Accountants in England and Wales

¹⁵⁸ Ibid

¹⁵⁹ Janette Rutterford, *Introduction to Stock Exchange Investment* (Macmillan 1985) "See generally"

¹⁶⁰ The Wilson Report, *Committee to Review the Functioning of Financial Institutions Report*, Chaired by Sir Harold Wilson (HMSO Command Paper 7837, 1980)

¹⁶¹ Ibid (n 149)

clients' money, that's why they invest in well-established and large companies on one hand; and in the company who's BODs can be influenced by them on the other hand. Resultantly they are blamed for doing short-term investments.

The Wilson Report¹⁶² did start a reaction and a few studies took after either supporting the conduct of them or censuring it. Similarly, IIs' risk unwilling investment techniques prompt smaller and new companies not being financially solid ventures, assumed the way of IIs' obligations. The IIs own extensive parts of value in numerous companies over the world, and the key pretended by them in CG cannot be thought little of.

The Wilson Report criticised the workings of IIs in four ways: the absence of accountability of IIs to strategy makers; the foreign investment of their assets; their act of not investing in new and small companies and; their short-term investment strategies. The Wilson Report was a big critique to IIs. However, it failed to provide rationale behind such activities of IIs. As it is logical and justified for IIs to have diversified portfolios and if foreign countries provide them higher returns with lower risks then they have rationale to invest overseas. As far as new and smaller companies are concerned, the transaction cost involved in these shares might not be sustainable for them.¹⁶³

Furthermore, Cosh *et al.*¹⁶⁴ analysed various issues worried with the connection between IIs' responsibility for the UK company securities and the financial performance of companies. One of the findings was that, no deliberate proof was found about the capacity and eagerness of IIs to apply impact over the strategy and approach of a company; in spite of the fact that the study noticed they were not as idle as by and large depicted.

¹⁶² Ibid (n 160)

¹⁶³ Stephen Bainbridge, 'Shareholder Activism and Institutional Investors' (2005) Law Econ Research Paper No. 05-20 <http://papers.ssrn.com/sol3/papers.cfm?abstract_id=796227> accessed 20 December 2015; Manya Srivardhan, 'Role of Institutional Investors in Corporate Governance' (2009) 1 <<file:///C:/Users/BMRI/Downloads/SSRN-id1391803.pdf>> accessed 20 December 2015

¹⁶⁴ Cosh *et al.*, 'Institutional Investment, Company Performance and Mergers: Empirical Evidence for the UK' (1989) 7(1) International Journal of Industrial Organisation 73

Similarly, Mallin¹⁶⁵ has also written substantially on the importance of IIs, their role and responsibilities, stewardship code and its effectiveness, and about the international CG norms. She also wrote about IIs and their Voting Practices: an International Comparison; and the role of IIs in CG.

Wilson Report,¹⁶⁶ Briston and Dobbins,¹⁶⁷ also investigated numerous issues addressing the link between the activism of IIs and the performance of the UK companies. They found a considerable improvement in companies' performance and strategies where institutional shareholders took part actively in the companies' matters and highlighted and criticised the mal-practices of managers. They use the strategy of exit if company management does not recognise their voice.

However, the Myners Report¹⁶⁸ highlighted that there is, indeed, need for more activism by IIs as they had traditionally been too passive and tolerant of poor performance. Simon Wong¹⁶⁹ wrote about the development and implementation of CCG and the UK stewardship code for IIs; he pointed out the efforts to convince IIs to be active stewards and the reasons why they have not been so.

Moving further, the study by Lehmann and Weigand¹⁷⁰ found that the presence of IIs owning the large portion of shares of traded companies expands corporate performance. Hart¹⁷¹ argues that IIs can attain adequate advantages from the

¹⁶⁵ Ibid (n 154) 104; Christine Mallin, 'Institutional and Other Shareholders' in Kent Baker and Ronald Anderson (ed), *Corporate Governance: A Synthesis of Theory, Research and Practice* (Wiley Publications 2010) "See generally"; Christine Mallin, 'Institutional Investors: the Vote as a Tool of Governance' (2012) 16 *Journal of Management and Governance* 177

¹⁶⁶ Ibid (n 160)

¹⁶⁷ Ibid (n 157)

¹⁶⁸ Myners' Report, *Myners Report on Institutional Investment* (HM Treasury London 2001) "See generally"

¹⁶⁹ Simon Wong, 'The UK Stewardship Code: A Mixed Opportunity for Higher Standards' (2010) *Responsible Investors* <<http://ssrn.com/abstract=1640897>> accessed 10 March 2015; Simon Wong, 'Developing and Implementing Corporate Governance Codes' (2008) <<http://ssrn.com/abstract=1321127>> accessed 10 March 2015

¹⁷⁰ Erik Lehman and Jurgen Weigand, 'Does the Governed Corporation Perform Better? Governance Structures and Corporate Performance in Germany' (2000) 4 *European Finance Review* 157

¹⁷¹ Oliver Hart, 'Corporate Governance: Some Theory and Implications' (1995) 105 *The Economic Journal* 678; Sanford *et al.*, 'Takeover Bids, The Free-Rider Problem and the theory of the Corporation' (1980) 11(1) *The Bell Journal of Economics* 42

investee company because of having a motivation to supervise because of vast shareholdings possessed by them, as compared to minority shareholders.

Similarly, Shleifer and Vishny¹⁷² (as discussed above) assert that, large shareholders have more noteworthy motivation to monitor the performance of investee companies when contrasted with the members of the BODs in the light of the fact that the members of BODs have no substantial investments in the company. However, this view is not right in case of Pakistan, where individuals from the BODs have more noteworthy stakes in the company being the owners either directly or indirectly.

In the same line, McConnel and Servaes¹⁷³ highlighted that the pioneering conduct of managers can be controlled by IIs as they have the ability to compel them to focus more on the application of CG norms. Likewise, Chung *et al.*,¹⁷⁴ argue that the large shareholdings owned by institutional shareholders, act as a warning for the managers in following astute objectives.

Moreover, Myners¹⁷⁵ and Cheffins¹⁷⁶ contend that the essential purpose behind the ascent of institutional share ownership in the UK is tax benefits for institutions. For instance, pension funds are excluded from the capital gain tax and commitments to such finances by their recipients are made out of pre-tax wage. Paul¹⁷⁷ confirms that the increment in private retirement funds, as insurance and pension schemes, is another cause enhancing the development of institutional investment in the UK.

¹⁷² Andrei Shleifer and Robert Vishny, 'Large Shareholders and Corporate Control' (1986) 94(3) *Journal of Political Economy* 461, 462

¹⁷³ John McConnell and Henry Servaes, 'Additional Evidence on Equity Ownership and Corporate Value' (1990) 27 *Journal of Financial Economics* 595, 597

¹⁷⁴ Richard Chung *et al.*, 'Institutional Monitoring and Opportunistic Earnings Management' (2002) 8(1) *Journal of Corporate Finance* 29

¹⁷⁵ Paul Myners, 'Institutional Investment in the United Kingdom: A Review' (London 2001) 27

¹⁷⁶ Brian Cheffins, *Corporate Ownership and Control: British Business Transformed* (Oxford University Press 2008) 346

¹⁷⁷ Paul Davies, 'Institutional Investors in the United Kingdom' in Daniel Prentice and Peter Holland (eds), *Contemporary Issues in Corporate Governance* (Clarendon Press New York 1993) 69

Hobson¹⁷⁸ and Clark¹⁷⁹ contend that the aggregate investment through institutions likewise permits people to increase their venture ultimately amongst a much more extensive scope of companies, in this manner decreasing their disclosure to the danger of a debacle from any such company breakdown and people might declare that IIs are more skilled in choosing the better suitable companies for their investments.

Moreover, McCahery *et al.*¹⁸⁰ find that, CG is of importance to institutional shareholders in their investment decisions and a number of them are willing to engage in shareholder activism. According to Demb and Neubauer,¹⁸¹ over the last five years or so there has been increasing pressure from government, ultimate beneficiaries, and various stakeholders on IIs to engage with their investee companies. Gompers *et al.*,¹⁸² show that companies with more grounded shareholder rights good reputation, higher benefits, higher increase in sales, most reduced capital consumptions and made less corporate acquisitions.

In addition, the discoveries of LLSV,¹⁸³ demonstrate that powerless shareholder insurance restricts abundance to outside fund. Shleifer and Wolfenzon¹⁸⁴ contend that providing improved disclosure and transparency of data to the investors, and the requirement of laws that ensure shareholders' rights, diminish the expenses of outside fund.

¹⁷⁸ Dominic Hobson, *The National Wealth: Who Gets What in Britain* (HarperCollins 1998) 1035

¹⁷⁹ Robert Charles Clark, 'The Four Stages of Capitalism: Reflections on Investment Management Treaties' (1981) 94(3) *Harvard Law Review* 561

¹⁸⁰ Joseph McCahery *et al.*, 'Behind the Scenes: The Corporate Governance Preferences of Institutional Investors' (2010) Tilburg Law School Research Paper No. 010/2010 <<http://ssrn.com/abstract=1576041>> accessed 1 December 2015; Joseph McCahery *et al.*, 'Behind the Scenes: The Corporate Governance Preferences of Institutional Investors' (2015) 1 <<http://abfer.org/docs/2015/program-2/behind-the-scenes-the-corporate-governance-preferences-of-institutional-investors.pdf>> accessed 01 January 2016

¹⁸¹ Ada Demb and Friedrich Neubauer, *The corporate Board: Confronting the Paradoxes* (Oxford University Press 1992) 193

¹⁸² *Ibid* (n 73) 108

¹⁸³ LLSV, 'Investor Protection and Corporate Valuation' (2002) 57(3) *The Journal of Finance* 1147, 1150

¹⁸⁴ Andrei Shleifer and Daniel Wolfenzon, 'Investor Protection and Equity Markets' (2002) 66 *Journal of Financial Economics* 3

Perotti and Volpin¹⁸⁵ give prove that better shareholder security not just support rivalry and passage into the advanced economic framework, it is likewise good for the politically responsible states and IIs have capacity to exert pressure on companies to achieve these objectives. Further, they also recommend that enhancing formal shareholder security rules whereas disregarding its implementation might not enhance profits.¹⁸⁶

Specifically, shareholders can appoint directors as a response to the company performance, but likewise the performance of the company may also be in response to the appointment and/or contribution of an experienced director. Both the variables of company performance and director experience may impact upon each other. Consequently much of the research in governance yields conclusions that refer to ‘associations’ between governance factors and performance, as opposed to attributing causality.¹⁸⁷

In 2011, OECD¹⁸⁸ published a report on the role of IIs in promoting good CG. The Report conducted the in-depth investigation of the role of IIs in promoting good CG in three countries: Australia, Chile and Germany. The Report asserts that the OECD Principles of CG are developed on an assumption that shareholders can safeguard their interests in much better way if they have right and proper access to information. The Report acknowledged the importance and impact of IIs by concluding that the increased existence of IIs in the last decade has raised this expectation that a new community of highly skilled, experienced, well-resourced professional shareholders will protect their rights in more efficient way and promote CG principles in their investee companies.

¹⁸⁵ Enrico Perotti and Paolo Volpin, ‘The Politics of Investor Protection and Competition’ (2012) <<http://faculty.london.edu/pvolpin/lobbying.pdf>> accessed 10 March 2015

¹⁸⁶ As discussed in section 2.4.3. It also justifies the importance of strong enforcement mechanisms this thesis seeks to investigate in Pakistan.

¹⁸⁷ Ibid (n 185)

¹⁸⁸ Corporate Governance, ‘The Role of Institutional Investors in Promoting Good Corporate Governance’ (OECD 2011) <<http://www.oecd.org/daf/ca/49081553.pdf>> accessed 20 June 2015

This researcher submits that, although some studies (analysed above)¹⁸⁹ criticise IIs for their policies and short-term investment strategies; a large number of studies (both theoretical and empirical) acknowledge their importance and conclude that IIs have much potential owning large portion of shareholdings to improve companies' performance. They can monitor and influence the activities and policies of BODs, can exert pressure on management for the better compliance of CCG, the appointment of experienced and independent directors, protect shareholders' interests; and by doing all this can help in increasing companies' performance.

They use the strategy of exit (as discussed above) if company management does not recognise their voice, which is highly useful strategy as management would not prefer to lose a large portion of shareholding of their ventures.¹⁹⁰ The analysis of these studies confirm the importance of IIs in today's corporate world and therefore establish the significance of the objective of this research; that is to explore the part of IIs in promoting CG in Pakistan.

Shleifer and Vishny¹⁹¹ assert that, although a great part of the current literature depends on the working of the companies of advanced jurisdictions, and consequently postulates a more extensive dispersion in ownership structure in contrast to transitioning economies. Such as in Pakistan where substantial shareholdings are basic as concentrated ownership, it is contended that large investors' motivating force and capacity to obtain data and to monitor administration decrease agency costs.

Mahmood and Sharif¹⁹² conducted a study to explore the institutional ownership design in Pakistan for both the government-owned and privately owned institutions, using data from haphazardly selected companies listed on KSE. This

¹⁸⁹ For example, the Wilson Report (n 160), Briston and Dobbins (n 157)

¹⁹⁰ Alessio Paces, 'Exit, Voice and Loyalty from the Perspective of Shareholder Activism in Corporate Governance' (2015) 1 <http://web.law.columbia.edu/sites/default/files/microsites/law-economics-studies/20151105_paces_shl_activism.pdf> accessed 20 December 2015

¹⁹¹ Ibid (172) 461

¹⁹² Shahnawaz Mahmood and Haroon Sharif, 'Institutional Shareholders and their Role in Promotion of corporate Governance in Pakistan' Working Paper <www.secp.gov.pk/IACCD/pub_iaccd/WORKING%20PAPERS.pdf> accessed 10 March 2015

was a pioneering research work in this direction in Pakistan. They specifically investigated the role of institutional shareholders in the promotion of CG and attempted to investigate the part of IIs activism for two specific viewpoints: selection of NEDs and external auditors.

They further investigated the role of nominee directors on the board. They found that financial institutions are block-holders in Pakistan. They found that 45% of companies have possessions more prominent than 20%. In this manner a lot is on the line and motivating forces for shareholder activism are available. Likewise candidate executives of these block holders are available on 60% of test companies' BODs. In spite of the fact that the legal environment in Pakistan is not prospering the business sector for corporate control specifically for non-banking financial sector, proxy voting is permitted and there is no limitation on harmonisation among institutions.

The criticism on this study is that it was conducted in the year 2001 therefore the situation in 2001 and today is quite different; secondly they (Mahmood and Sharif) used sample of non-financial privately owned companies; however this thesis seeks to explore the role of IIs for public listed companies. Notwithstanding, the difference of public or private companies does not matter as much; because the sole intention of this thesis to explore ways to improve CG practices in Pakistan.

The major criticism on their study is that they did not answer the actual question they posed for their research. As the aim of their research was to examine the part of IIs in relation to the appointment of NEDs and external auditors; they did not provide answer any of these. They provided the reason that they could not explore the activism of IIs due to the lack of complete data and improper way of recording the minutes of Annual General Meeting (AGM) proceedings.

However, they highlighted some significant points; for example, they find that 45% of companies have holding greater than 25%, therefore motivation and scope exists for the activism of shareholders; however the laws of Pakistan put limitations on institutional shareholding and therefore do not support IIs. This is

an evidence of stance of the researcher of this thesis that the corporate laws of Pakistan are weak and unsupportive and require reforms. Secondly, their study also declares FOEs as a major reason for the limited appearance of IIs in Pakistani companies and the compliance with CCG.

Syeda Saima¹⁹³ conducted a study regarding the role of IIs activism in CG of Pakistan. She posed the aim of her article to explore the part of institutional shareholders' involvement in improving CG standards in investee companies of Pakistan. However, she did not explain that how she will conduct her study, in which investee companies she will explore the role of IIs.

Her study is based on the UK and the USA based literature and takes a stance that IIs can assume a major part in the CG of Pakistani companies only if they become active, as currently they are doing very less efforts in order to improve the CG environment in Pakistan mostly because of their inactive part and half way the non-efficacy of the CCG and corporate laws. But she does not provide any evidence for her statements. In the end, she highlighted that the corporate laws of Pakistan are weak which was not actual aim of her study; likewise she listed some recommendations for SECP to consider for the improvement of CG but again neither it was her objective nor she justified on what basis she is posing these recommendations.

These were the only two studies this researcher could find mainly focussing on the role of IIs in CG of Pakistan. The analysis of these both studies confirms that there is a much room for this topic to explore further both theoretically and empirically. This thesis fills this gap by exploring the part of IIs in promoting CG principles in Pakistan theoretically in more strategic way instead of conducting empirically due to the methodological limitations provided in chapter three. The researcher submits that, though this thesis will fill this gap; however much room will still remain to be explored for future studies.

¹⁹³ Syeda Shabbir, 'The Role of Institutional Shareholders Activism in the Corporate Governance of Pakistan' (2012) 1(2) Journal of Humanities and Social Sciences 1

2.5 Gap in Literature: Addressed by this Thesis

This section presents a brief discussion on the potential research gap relating to the importance of CG principles for the performance of companies; significance of strong enforcement mechanisms; effectiveness of BODs and; the part of IIs in CG. The existing literature on these issues is critically reviewed which yields significant findings beyond the existing theoretical perspectives and justifies and validates the aim and objectives of this thesis. The literature review conducted in this chapter confirms that these topics are worth investigating as they have considerable impact on the growth of CG of investee companies which leads to the growth in the economy of a country. The following paragraphs provide gaps in literature one by one relating to the each objective (research question) of this thesis.

Firstly, a number of studies advocate the importance of CCG for the better performance of companies. However, very few studies are undertaken mainly focussing on Pakistan's perspective, and talks about the weaknesses in the CCG of Pakistan. The difference between those studies and the first objective of this thesis is that, this thesis not only declares the provisions of CCG of Pakistan weak and overlapping with other corporate laws, rather it identifies those provisions and also formulates recommendations to improve them. Secondly, the prior studies only talks about the old version of CCG 2002, however this thesis first time analyses the provisions of current CCG 2012 of Pakistan.

Secondly, the existing literature put emphasis on the issue of proper compliance, implementation and enforcement of CG principles, and corporate laws. The academics of CG consider the reforms in 'law in action' as important as 'law in books'. A few studies particularly relating to Pakistan have also been conducted. However, those studies confirm that the enforcement mechanisms in Pakistan are weak and ineffective but do not provide the solutions and measures to improve implementation of CCG and enforcement mechanisms in Pakistan relating to CG principles.

Moreover, those studies identify a few factors such as, FOEs and SOEs responsible for the non-enforcement of CG in investee companies of Pakistan. However, this thesis not only identify a number of other factors which do not let the CG to grow in listed companies of Pakistan rather it provides detailed mechanisms of reform to take appropriate measures which can improve the compliance of CG principles, and the enforcement mechanism in Pakistan.

Thirdly, a significant number of existing literatures confirms that the size, composition and independence of BODs are key factors which make BODs effective. Although the outcomes of those studies are relatively mix on the points whether larger or smaller boards are more effective; BODs with majority of executive or NEDs are more effective and; whether more independent BODs are more effective.

However, there are only two studies available so far relating to Pakistan primarily focusing on the association between size of BODs and companies performance and the composition of BODs and companies performance conducted by Zulfiqar and Safdar, and Arshad and Safdar, which confirm that there is a considerable room of research in this area. This study fills this gap as it seeks to develop a board effectiveness model for Pakistani listed companies by investigating the variables; size, composition, diversity and independence of BODs.

Lastly, the literature review conducted on the role and importance of IIs in their investee companies confirm that IIs can be instrumental as agents of change because of having large shareholdings and being professional and experienced investors. They can influence BODs of their investee companies and can make compliance with CCG better which may lead to the emergence of more accountable BODs to their shareholders and more transparent in their disclosure requirements.

However, there are only two studies focussing on Pakistan exploring the role of institutional shareholders in CG of Pakistan, which confirms that this topic requires further research. This thesis fills this gap by exploring the role of IIs in promoting CG practices in their investee companies in Pakistan. This thesis

investigates that which incentives can make IIs active to work in Pakistani companies and; which can be the appropriate methods through which IIs can intervene in the policies and strategic decision-making of their investee companies.

2.6 Conclusion

This chapter has presented the review of existing literature and the theoretical foundations of this study. The literature review is conducted relevant to the research aim and objectives of this study in the way of a comprehensive critical analysis on the significance of CCG, compliance with CG principles and strong enforcement mechanisms, effectiveness of BODs and finally the part of IIs in CG of their investee companies, with concentrating on published work, raising questions, identifying areas of controversy and potential research gaps. The current chapter additionally offers noteworthy visions regarding diverse theories of CG in favour or against this thesis. A detailed discussion on research design, research methods and methodology essential to conduct this research is provided in the following chapter.

CHAPTER THREE: RESEARCH METHODS AND METHODOLOGY

3.1 Introduction

The previous chapter presents the literature review which establishes the presence of a gap in existing literature and establishes the significance to conduct a dedicated study in the area of Corporate Governance (CG) in Pakistan particularly regarding the effectiveness of board of directors (BODs) and the role of institutional investors (IIs). After identifying the research gap and research questions, it is essential to define the methodological and philosophical approaches deployed in this study.

The current chapter presents the epistemological grounds of this study and the rationale for a qualitative exploratory study using interpretative and descriptive approach on the enforcement mechanisms of CG, the role and effectiveness of BODs and the part of IIs in the corporate sector of Pakistan. Furthermore, it provides details of the data collection and data analysis methods used for this study, establish the trustworthiness of this thesis and justify the ethical considerations involved in this study. Figure 3.1 provides the plan of this chapter

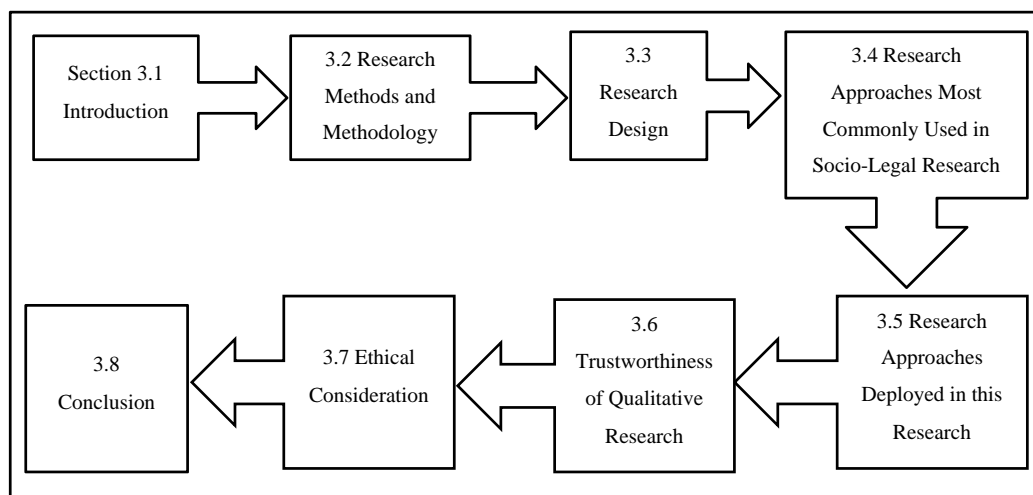


Figure 3.1: Plan of this Chapter

3.2 Research Methods and Methodology

Research methods and methodology are frequently confused to be the same, though this is not true.¹ McGregor and Murname² explained the difference between these two terms in the following words:

“The word methodology consists upon two words: method and ology, which implies a branch of knowledge; therefore, methodology is a branch of knowledge that deals with the common principles or maxims of new information. It alludes to the reasoning and the philosophical suppositions inherent to any natural, social or human science study, whether expressed or not.”

Table 3.1 clarifies the distinction between research methods and research methodology.

¹ Linda Smith, *Decolonising Methodologies – Research and Indigenous People* (2nd edition, Zed Books 2012) 12

² McGregor *et al.*, ‘Paradigm, Methodology and Method: Intellectual Integrity in Consumer Scholarship’ (2010) 34(4) *International Journal of Consumer Studies* 419

Table 3.1: Distinction between Research Methods and Methodologies³

Research Methods	Research Methodology
<ul style="list-style-type: none"> ▪ by which researchers carry out research into a particular subject. ▪ Methods are tools by which researchers collect and analyse data for example, qualitative or quantitative, interviews, surveys, case studies, document analysis, content analysis etc. ▪ It involves experiments, tests, surveys and the like ▪ Its aim is finding solutions to research problems ▪ For the current research study the research method is qualitative.⁴ 	<ul style="list-style-type: none"> ▪ describes the methods through which a researcher conduct his/her research ▪ Methodology is the study of those methods. It is a philosophy of research, or a school of thought for example, positivism, interpretivism, phenomenology etc. ▪ It involves numerous techniques to carry out research; for example, experiments, surveys and critical studies search ▪ It aims at the employing the right procedures to reach at solutions ▪ Methodology employed for this thesis is exploratory using interpretative and descriptive approaches.

As a corollary, it can be submitted that research methods intend to find solutions to research problems. However, research methodologies intend to consider deploying accurate procedures to find out solutions. Therefore, it can be concluded that research methodology defines and provides the means for research methods to conduct study appropriately. Research methodology is the start while research methods are the end of any scientific or non-scientific research which leads towards findings or conclusions.⁵

³ Developed by the researcher

⁴ Explanation is in following parts

⁵ Ibid (n 2) 420

3.3 Research Design

This section explains the basic elements of a research design and also provide the research design which this researcher is going to use for her study. The researcher believes that there are six basic aspects to design a qualitative socio-legal research study. Figure 3.2 shows those six stages.

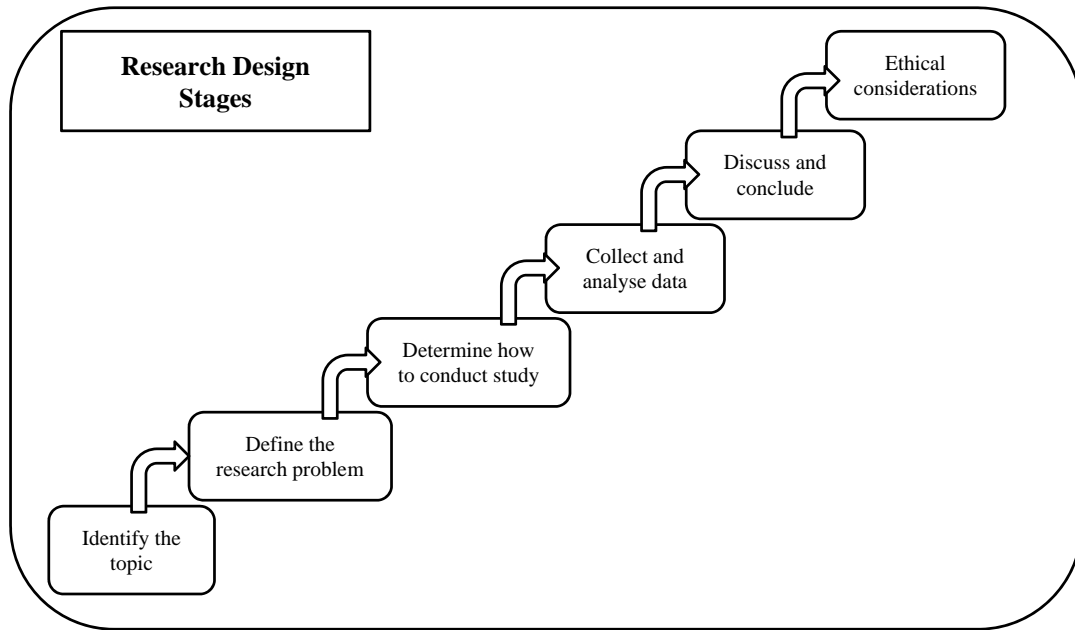


Figure 3.2: Research Design/Process Chart⁶

First, the researcher needs to identify a particular topic on which s/he aims to conduct research.

Secondly, to clearly define the dimensions of the research problem (as done in section 1.2.1), keeping in view that the problem area should not be too broad so that it becomes difficult for the researcher to unfold it within a specific time; neither should it be too specific and narrow that it cannot reach the level of doctoral work.

⁶ Developed by the researcher

Thirdly, the researcher needs to decide the technique, most suitable to obtain the answer of research question inside of any limitations, for example, restricted access to data, ethical contemplations, etc. A researcher will consider whether a case-study method, surveys and interviews, participant observation, document analysis,⁷ or a mixture of these techniques is expected to answer the research question.

Fourthly, the researcher will need to consider how to select her research subjects or document; and how many to select, in keeping with the data collection methods that she has chosen to adopt. Moreover, how the data is to be analysed; data analysis and the drawing of the conclusions and findings from the data are among the more contentious aspects of qualitative research. Will the researcher use a grounded theory method,⁸ content analysis,⁹ discourse analysis,¹⁰ thematic coding, historical or linguistic analysis, or statistical analysis?

Lastly, the researcher will need to conclude and provide the outcomes of the research and lastly ethical contemplations should be of primary concern for the researcher.

3.3.1 Research Design Employed For This Study

Figure 3.3 shows and explains the research design which is employed in this research. The research method adopted for this study is qualitative; however the methodology employed is exploratory. The philosophical stance of this study is interpretative, and descriptive which has been used to interpret CG rules, regulations and procedures; as this study is socio-legal study and combines both research methods.

⁷ Marc Bloch, *The Historian's Craft* (transl. Peter Putnam, Manchester University Press 1992) 91

⁸ Barney Glaser and Anselm Strauss, *The Discovery of Grounded Theory: Strategies for Qualitative Research* (Aldine 2012) 15

⁹ Martin Bauer, 'Classical Content Analysis: A Review' in Martin Bauer *et al* (eds), *Qualitative Research with Text, Image and Sound A Practical Handbook* (Sage Publications 2000) 132

¹⁰ Rosalind Gill, 'Discourse Analysis' in Martin Bauer *et al* (eds), *Qualitative Researching with Text, Image and Sound A Practical Handbook* (Sage Publications 2000) 172

Furthermore, exploratory philosophy is used to explore the authorities' intention behind the legislation and to explore the solutions of identified problems in this study. Lastly, the descriptive philosophy is used to describe the current position of the working of BODs and IIs in Pakistan, in order to establish the worth and originality of this research.

The research approach employed in this thesis is inductive. The deductive approach is rejected. The first reason for employing inductive approach and rejecting deductive approach is that; the qualitative studies mostly rely on inductive reasoning however; quantitative studies are associated with deductive reasoning.¹¹ As the study conducted for this thesis is qualitative, the inductive approach is more suitable for this study.

Secondly, the deductive approach works on a general hypothesis made before data collection; while the studies adopting inductive approach seeks to derive study patterns and general themes from the data collected as the research progress. And this thesis in current form is derived from the data collected time-to-time with the progress of research, it has to be changed many times based on studies and moulded in its current form. Therefore, the inductive reasoning best describes the procedures followed in this thesis.

Data has been collected by using both primary and secondary sources. The detailed explanation of this research design is provided in part 3.5 of this chapter.

¹¹ Lisa Webley, 'Qualitative Approaches to Empirical Legal Research' in Peter Cane and Herbert Kritzer (eds), *The Oxford Handbook of Empirical Legal Research* (Oxford University Press 2010) 38

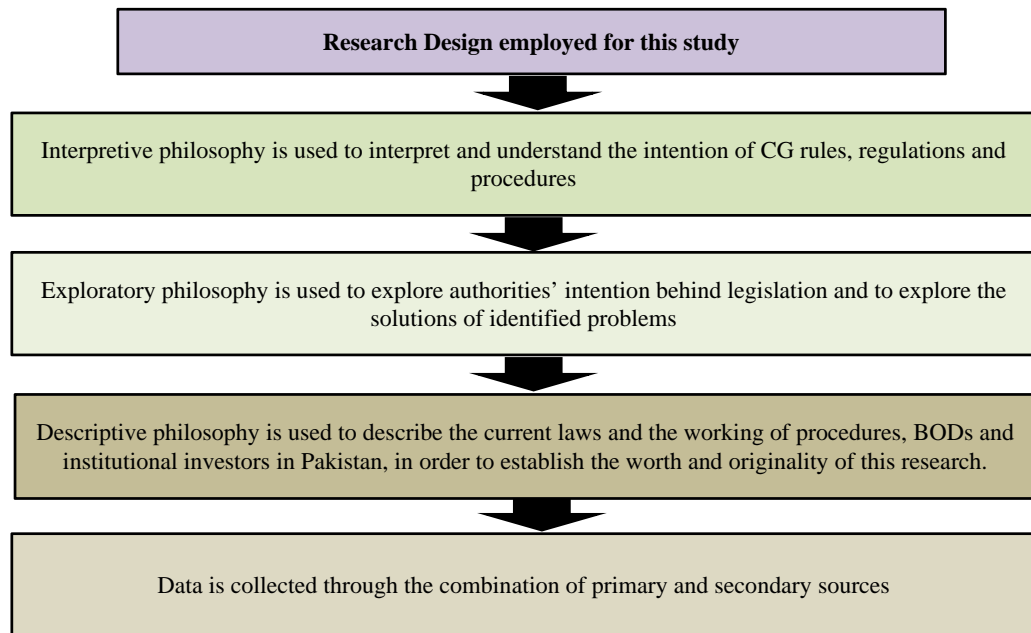


Figure 3.3: Research Design Deployed for this Study¹²

3.4 Research Approaches Commonly Used in Socio-Legal Research

This section provides a general discussion regarding the research methods and methodologies which are usually adopted for a socio-legal study. It is important to discuss them here so that the reader can understand the process employed in choosing a particular method and methodology most appropriate for this contemporary research work.

Legal research is the process of obtaining information necessary to support legal decision-making.¹³ Broadly speaking, legal research originates with an analysis of the realities of a problem and concludes with finding the results of investigation.¹⁴ As is done in this research by analysing and investigating the problems of corporate failures in Pakistan and the findings of this study provide measures to improve corporate governance (CG) of Pakistan which will reduce these failures. Socio-legal studies cannot consider methods only without knowing the usage of

¹² Developed by the researcher

¹³ Ibid (n 11) 39

¹⁴ Ibid (n 11) 39

those methods in diverse theoretical backgrounds, which means that theory and method are inextricably inter-linked.¹⁵ All research studies depend on a specific vision of the world utilise a methodological approach and suggest outcomes went for predicting, analysing and explaining, describing or exploring.¹⁶ The following figure shows these stages.

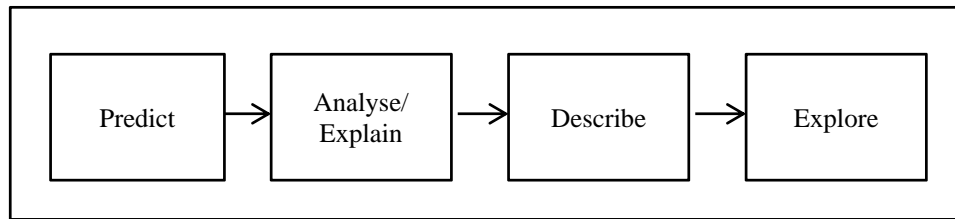


Figure 3.4: Showing Research Stages¹⁷

These stages have been used in this study in descending order. Table 3.2 shows that how these stages are applied in this research.

Table 3.2: Research Design Phases and Stages¹⁸

Research Design Stages	Explore	Describe	Analyse/ Explain	Predict
Identify topic	Yes	Yes		
Define research problem		Yes		
Determine how to conduct study		Yes		
Collect data			Yes	
Analyse data			Yes	
Discuss and conclude			Yes	Yes

There is no consensus as to the definition of socio legal studies. Thomas¹⁹ defines it as: ‘socio in socio legal does not refer to sociology or social sciences, but represents a line with a background within which law exists’. Campbell and

¹⁵ Peter Cane and Herbert Krtizer, *The Oxford Handbook of Empirical Legal Research* (Oxford University Press 2010) “See generally”

¹⁶ Raymond – Alain Thietart *et al.*, *Doing Management Research: A Comprehensive Guide* (Sage Publications 2001) 19

¹⁷ Developed by the researcher

¹⁸ Developed by the researcher

¹⁹ Phil Thomas and Wheeler, *Socio legal studies* (Hart Publishers 2000) 267

Wiles²⁰ differentiated the socio legal work from the work relates to sociology of law.

Empirical research in law is the norm.²¹ Reading cases and statutes and ascribing (legal) meaning to these texts, to attempt to discover ‘what is the law’ is actually a form of qualitative research, using documents to ascribe meaning given a shared code of understanding about what different words mean.²² This is exactly what is done in this study. The researcher has analysed CG rules and regulations of Pakistan to understand the meanings of their provisions, to get the intention of legislature and to examine the affect/implementation of CCG in the listed companies of Pakistan.

Socio-legal research in law is less usual.²³ It goes beyond legal documents, to analyse the law through different media. It may consider context and structure. It considers ‘law’ widely defined, and in situ, using social-science techniques (the socio) as well as legal techniques (the legal).²⁴ As this study is not purely legal, it contains some legal elements as well as some business, commercial and social elements. Therefore, socio-legal method is more suitable for this study.

Broadly, there are three types of research methods; qualitative (which emphasise on developing theory and generating knowledge), quantitative (which emphasise on testing theory and hypothesis) and mixed method (which tends to unite both research methods).²⁵

Qualitative methods are different from that of quantitative, such as: a ‘qualitative research’ recognises the existence or non-existence of something; however ‘quantitative research’, deals with calculating the degree to which some elements

²⁰ Collin Campbell and Paul Wiles, *law and Society* (Barnes and Noble Imports 1979) 2

²¹ Ibid (n 15)

²² Hazel Genn, *Paths to Justice: What Do People Think About Going To Law?* (Hart Publishing 1999) 67

²³ John Flood, ‘Chapter 2 Socio-Legal Anthropology’ in Reza Banakar and Ma x Travers (eds), *Theory and Method in Socio-Legal Research* (Hart Publishing 2005) 33

²⁴ Ibid

²⁵ John Creswell, *Research design Qualitative, Quantitative and Mixed Methods Approaches* (4th edition Sage Publications 2014) 155

exist.²⁶ Thus, qualitative investigation does not deal with statistical quantification, however endeavours to obtain and categorise social phenomenon and their meanings.²⁷

In epistemological²⁸ terms, quantitative research is often associated with positivism (objectivist, scientific, traditional, explanatory and deductive), while qualitative research tends to be rooted in phenomenology (subjectivist, humanistic, interpretative, exploratory, descriptive and inductive), however mixed method is associated with pragmatism.²⁹ Some authors argue that descriptive approach also comes under quantitative research.³⁰

The following diagram shows almost all available choices of research methods and methodology.

²⁶ Jerome Kirk and Marc Miller, *Reliability and Validity in Qualitative Research* (Sage Publications 1986) 20

²⁷ Ibid (n 9) 140

²⁸ Epistemology is one's understanding of the nature of knowledge

²⁹ Gary King *et al.*, *Designing Social Inquiry Scientific Inference in Qualitative Research* (Princeton University Press 1994) 3

³⁰ Herbert Kritzer, 'The Data Puzzle: The Nature of Interpretation in Quantitative Research' (1996) 40(1) *American Journal of Political Science* 1; Herbert Kritzer, 'Conclusion: "Research is a Messy Business" An Archaeology of the Craft of socio-Legal Research' in Simon Halliday and Patrick Schmidt (eds), *Conducting Law and Society Research: Reflections on Methods and Practices* (Cambridge University Press 2009) 264

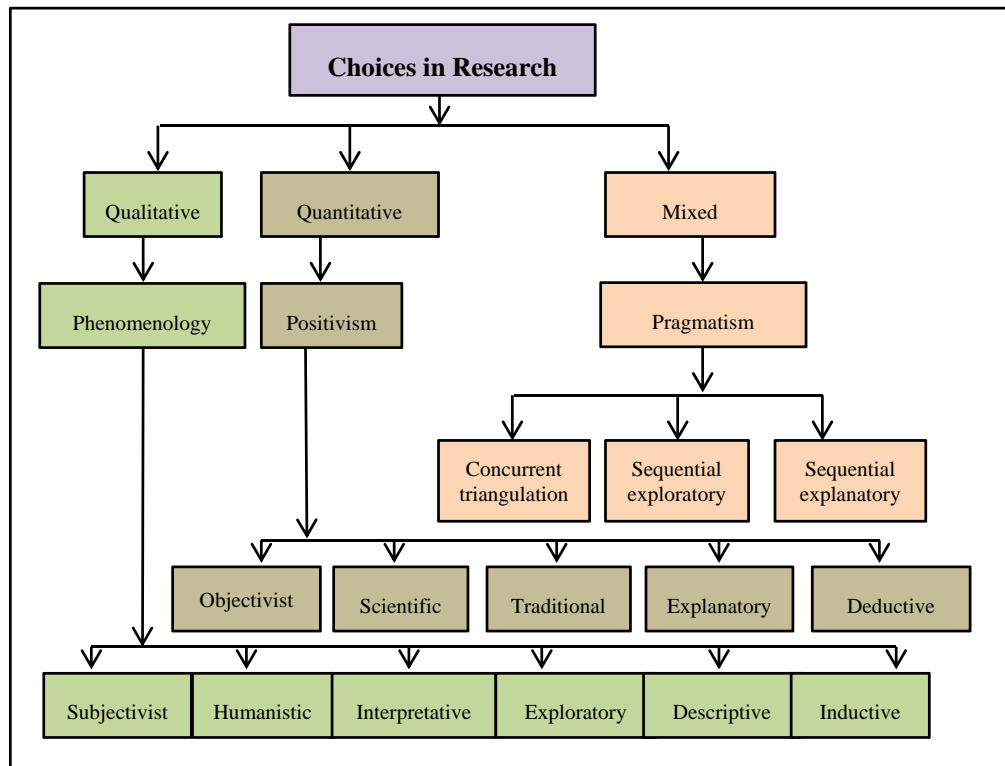


Figure 3.5: Choices Available in Research Methods³¹

3.5 Research Approaches Deployed in this Study

This research employs a qualitative research method. It is difficult to provide a precise or widely accepted definition of qualitative research and its underpinning theory. Most researchers who conduct qualitative research would agree that it is socially concerned, examines phenomenon in their social settings (if field work is undertaken) and considers those phenomenon in context.³²

For this investigation, a variety of research methodologies, methods and techniques have been considered before choosing the most appropriate and rejecting others.

³¹ Developed by the researcher

³² Ibid (n 25) 157

A quantitative approach has been rejected because the quantitative methods provide statistical investigation by calculating certain aspects mathematically in figures.³³ Quantitative data is self-explanatory and does not need human interpretation. As this study does not involve statistical investigations there is no need to employ a quantitative method.

Moreover, positivism and phenomenology have been rejected as being inappropriate and irrelevant for this study. Phenomenological methodology requires valuing the behaviour of the participants in their own subjective frame of reference. Given that there are no direct participants involved in this study the phenomenological methodology has also been rejected. Likewise, positivistic methodology requires the studying of human behaviour in a similar way as research conducted in the natural sciences. Therefore it has also been rejected as having nothing to do with the current study.

This study aims to identify the key problems in Pakistani code of corporate governance (CCG), explore the solutions for them, investigate and explore the role of BODs and IIs in Pakistani listed companies. For this reason a qualitative research is more suitable, as it identifies the presence or absence of something.

3.5.1 Data Collection Tools

In qualitative studies, the data is commonly obtained by three key methods, separately or in combination: analysis of documents, direct observation and in-depth interviews.³⁴ For this research work, the method of document analysis is used as being the most appropriate method, keeping in view the research objectives (see section 1.3) as it involves the investigation of CCG, investigation about the current corporate practices prevalent in Pakistan through the companies' annual statements and using primary and secondary sources.

³³ Ibid (n 25) 157

³⁴ Tim May, *Social Research: Issues Methods and Practices* (3rd edition, Open University Press 2001) 138; Michael Patton, *Qualitative Research and Evaluation Methods* (3rd edition, Sage Publications 2002) 4; Keith Punch, *Introduction to Social Research* (2nd edition, Sage Publications 2005) 139

Direct observation is rejected as there is no human participation involved in this study.

Furthermore, using interview or questioner techniques would not be useful for this study because the potential contributors would be government and SECP officials, investors, directors and managers of top listed companies. Government officers have their own restrictions to reveal the truths and admit irregularities in the whole procedure of laws, strategy development and its enforcement, particularly in Pakistan's scenario where government officials set examples to break law and non-adoption of CCG (as established in section 1.2.1). Likewise investors particularly IIs would never admit any weaknesses on their part.

Moreover, companies' directors and managers' stance would not be different from their disclosure statements, so the annual reports of companies would serve this purpose. State functionaries, companies' officials and investors would endeavour to draw the whole examination in their favour and, consequently, this technique would not be useful to collect impartial and reliable data.

Another important and contributing factor for not conducting interviews is the restricted financial resources and the security situation of Pakistan these days. Several incidents lead the researcher to stick to desk based research.

First, the researcher is a sponsored student, as soon as she passed her RS1 her sponsor stopped her funding (due to sponsor university's internal politics), which remained stopped for more than a year and finally reimbursed with the order of High Court.

Secondly, all major listed companies of Pakistan are based in Karachi, and the security situation in Karachi has been worse throughout this period of time due to, terrorist attacks, target killings, political instability and many more.

The offices of government officials, financial institutions and some IIs are also based in Islamabad and Lahore. The researcher even could not go to those cities, because of an Azadi March held in Islamabad started from Lahore by Pakistan Tehrik-E-Insaf (political party) in Pakistan from 14-08-2014 to 17-12-2014 after

that the security situation became even worse followed by a massive and one of the most terrible terrorist attack on Army Public School Peshawar which killed 141 children and many more. Therefore, the methodology to conduct this study had to be changed.

However, the researcher believes and her research outcomes show that not conducting interviews did not affect this study in any way. Therefore, the desk based research employing document analysis method by using both primary and secondary sources are the more suitable data collection tool for this study.

3.5.1.1 Document Analysis

Data can be collected through document analysis ranging from official to the public.³⁵ Document analysis has several approaches, and there is insufficient space here to discuss them all. Concisely, the method of analysis³⁶ partially depends on the nature of the documents, for instance whether they are formal³⁷ or informal communications.³⁸ Some researchers may consider the context within which the documents were written and their intended audience. Others may examine the substance of the document but not its context.

The critics of document analysis method argue that documents are susceptible to scientific, systematic analysis in keeping with positivist traditions.³⁹ This researcher submits that this criticism does not apply on this study as this study is neither positivist nor scientific. This is socio-legal study and socio-legal researches usually use and support document analysis method.⁴⁰ Socio-legal researchers argue that, documents reflect or report reality, describing an event, a perception or an understanding.⁴¹

³⁵ Ibid (n 11); Lisa Webley, *Adversarialism and Consensus? The Messages Professional Bodies Transmit About Professional Approach and Professional Identity to Solicitors and Family Mediators Undertaking Divorce Matters* (IALS: London 2008) “See generally”

³⁶ The mode of selecting and extracting data from documents

³⁷ Legislations, case reports, newspaper articles or policy documents

³⁸ Informal discussions, private letters, solicitor file notes etc.

³⁹ Alan Bryman, *Social Research Methods* (3rd edition, Oxford University Press 2008) 515

⁴⁰ David Silverman, *Qualitative Research* (3rd edition, Sage Publications 2011) 77

⁴¹ May (n 34) 158

An alternative argument is that documents represent the practical requirements for which they were created for, or in other words the purpose of the document. For many researchers, documents offer confirmation of strategy guidelines, legislative aim, and identifications of potential weaknesses or good practice in the legal framework.⁴² This is exactly the purpose of choosing document analysis method for this study.

The researcher's aim is to analyse the policy directions of the authorities, to explore the legislative intention and to investigate the shortcomings or the best practice in the legal system of Pakistan in order to find the true spirit of CCG for the better implementation of CG best practices in Pakistani listed companies. For this purpose both primary and secondary data is used. Following table provides the list of primary and secondary data which is used in this study.

Table 3.3: Sources of Data⁴³

Primary Data	Secondary Data
<ul style="list-style-type: none"> ❖ Corporate Laws, Statutes ❖ Code of Corporate Governance ❖ Financial Statements ❖ Companies' Disclosure Statements ❖ Business Reports of Companies ❖ Government Publications ❖ World Bank Reports ❖ Published Research ❖ Cases ❖ Judicial Decisions ❖ Theses ❖ Surveys ❖ Conference Proceedings 	<ul style="list-style-type: none"> ❖ Internet ❖ Books ❖ Journal Articles ❖ Online Journals ❖ Working Papers ❖ Newspapers ❖ Business Magazines ❖ Business News ❖ Business Shows ❖ Some government publications

⁴² Ibid (n 34) 140

⁴³ Developed by the researcher

3.5.2 Data Analysis Tools

Data analysis and the drawing of conclusions and findings from the data are among the more contentious aspects of qualitative research. How can a researcher derive valid and dependable findings from the realms of documents?

Miles⁴⁴ explains that: the major difficulty in using the qualitative data is its mode of analysis, as they are not well defined and articulated unlike quantitative data which has clearly defined conventions that a researcher can use. However, the analysts of qualitative data have very limited guidelines for protection against self-delusion.

There are three relatively widely used modes of document analysis: content analysis, discourse analysis and the grounded theory method. Gibbs⁴⁵ states that: the document analysis includes identification, classification and recording of one or more paragraphs/portions of text or other data items such as the parts of pictures that, in some sense, demonstrate the same descriptive or theoretical idea. Typically numerous passages are chosen and then they are given a particular name called the code.

In qualitative research, code symbolises the comprehensive and significant portion of data relevant to researcher's work. This data can be in the form of observation field notes, interview transcripts, policy documents, journals, internet sites; literature, email correspondence etc.⁴⁶

The coding of data normally consists upon two cycles. In first cycle, the coded data can consist upon a single word, a paragraph or a full page of text. In the second cycle of coding process, the coded data can comprised of exactly relevant units, passages of text and analytic memos of the data developed so far.⁴⁷

⁴⁴ Matthew Miles, 'Qualitative Data as an Attractive Nuisance: The Problem of Analysis' (1979) 24 *Administrative Science Quarterly* 591

⁴⁵ Graham Gibbs, *Analysing Qualitative Data* (Sage Publications Ltd 2007) 38

⁴⁶ *Ibid* (n 10)

⁴⁷ Johnny Saldana, *The Coding Manual for Qualitative Researchers* (2nd edition, Sage Publications 2013) 3

According to Charmaz,⁴⁸ coding is a ‘critical link’ between data collection and the meaning of their explanation.

All methods of document analysis (content analysis, discourse analysis, grounded theory) seek to develop codes and to use those codes in slightly different ways.

The method of classical content analysis is used in this study as a data analysis tool however, discourse analysis and grounded theory is rejected.

The grounded theory method is rejected because it involves developing a theory which generates theory from the collected data and it follows the natural pattern of human inquiry.⁴⁹ Though the purpose of this study is neither generating a theory, nor any human participation is involved in it therefore; this method is not suitable for this dissertation.

Discourse analysis focuses on texts and examines the use of language, syntax, grammar, pauses, hesitations, repetitions, and so on in the discourse being studied. It is an extremely detailed method that analyses the text word by word, pause by pause, coupling description with evaluation.⁵⁰ All forms of texts may be analysed and it is the structure of the discourse rather than the meaning behind the text that is the key object of the study. The organisation of the text and its content are the subject of the inquiry. This form of analysis does not attempt to uncover objective facts.⁵¹ That is why this method is rejected because it does not unearth the context and objective behind a writing or document. This method may be best suitable for language studies but not for this study.

As the aim of this research is to explore facts and analyse the documents and reports in order to examine that what role IIs and the BODs can play in promoting

⁴⁸ Kathy Charmaz, ‘Grounded Theory’ in Robert Emerson (eds) *Contemporary Field Research: Perspectives and Formulations* (2nd edition, Prospect Heights, IL: Waveland Press 2001) 335

⁴⁹ Kathy Charmaz, *Constructing Grounded Theory: A Practical Guide Through Qualitative Analysis* (Thousand Oaks CA: Sage 2006) 42

⁵⁰ Ibid (n 11) 39

⁵¹ Gee *et al.*, ‘Discourse Analysis’ in Le Compte *et al* (eds), *The Hand Book of Qualitative Research in Education* (San Diego CA: Academic Press 1992) 227

CG in Pakistani listed companies; therefore there is no need to use discourse analysis as a tool of data analysis in this study.

3.5.2.1 Content Analysis

This thesis adopts content analysis as a tool for data analysis due to many reasons. Firstly, content analysis has wider application.⁵² Secondly, it can be utilised to examine the nature and frequency of particular types of legal phenomenon within press reports or legal cases, or to consider the content of strategy documents.

Content analysis can be descriptive, delineating the codes and the relationships between them, but it may also be used to explain or to develop a theory or theories.⁵³ Content analysts are usually more inclined towards a qualitative interpretation. Code selection and development are a matter of researcher interpretation and researcher judgment. The researcher will develop an index of descriptors with labels that summarise the essence of the code to allow data to be categorised.⁵⁴

The researcher reads the text to pull out emerging themes, attempting to make them as specific as possible by analysing how they are used, the limits of their use, the context within which they appear and so on. Some researchers may analyse using pen and paper, while others may use computer software such as NVivo and Atlas to assist them in their work. Computer assisted analysis may help to systematise coding, but it is still reliant on the researcher's selection of codes and her interpretation of the relationships between them.⁵⁵

Thirdly, content analysis can be a relatively highly systematised mode of qualitative data analysis, with relatively well-developed rules of sampling, selection of codes, and analysis of those codes and reporting of findings. Content analysis is reliant on a relatively large data set, which allows the researcher to

⁵² Lisa Webley (n 11) 12

⁵³ Margrit Schreier, *Qualitative Content Analysis in Practice* (London: Sage 2012) 20

⁵⁴ Philip Mayring, 'Qualitative Content Analysis' (2000) 1(2) *Qualitative Social Research* 20

⁵⁵ *Ibid* (n 29) "See generally"

interrogate the content of a range of documents to draw conclusions relating to a theme or themes or a group or groups such as, solicitors and judges.⁵⁶

3.5.3 Legal Methods of Data Analysis

After exploring the primary sources as mentioned in Table 3.3 this study will further use interpretive research philosophy to interpret and analyse the primary and secondary sources for example, corporate law, CCG, rules, regulations, principles and practices adopted to improve CG best practices, policies adopted by various governments, judgments of the court, text books, specialist commentary services, journal articles and previous research in the relevant field.

3.5.3.1 Doctrinal Legal Research

Doctrinal research is a research, which offers a systematic explanation of the rules and regulations governing a specific legal perspective, analyses the relationship between rules, identifies the problem areas and sometimes envisages future developments.⁵⁷ The word ‘Doctrine’ deals with the legal concepts and principles such as, cases, statutes, rules etc.

However, the doctrinal research is mainly qualitative.⁵⁸ As this study is not purely legal rather socio-legal (a combination of legal and corporate issues), therefore, doctrinal research methodology does not depict this study appropriately; instead qualitative method of research is suitable and appropriate for current study.

⁵⁶ Ibid (n 29) “See generally”

⁵⁷ Dennis Pearce, Enid Campbell and Don Harding, *Australian Law Schools: A Discipline Assessment for the Commonwealth Tertiary Education Commission* (Canberra: Australian Government Publishing Service 1987) “See generally”

⁵⁸ Nigel Duncan and Terry Hutchinson, ‘Defining and Describing What We Do: Doctrinal Legal research’ (2012) 17(1) *Deakin Law Review* 83; Lisa webley, ‘Qualitative Approaches to Empirical Legal Research’ in Peter Cane and Herbert Kritzer (eds) *Oxford Handbook of Empirical Legal Research* (Oxford University Press 2010) 1

3.5.3.2 Black Letter Law

Black Letter Law denotes to the principles of law, which are commonly known and independent from any doubt.⁵⁹ It demonstrates the well-established technical legal rules recognised by everyone in the legal sector. Black letter laws are those which provide the foundation for other laws to be established. For example, the definition of a contract, trademark and constitutional law is considered a black letter law, as nobody objects about what these laws are. As this study does not involve checking the foundation of any law and deals with the CCG, therefore, there is no need to use this Black Letter Law approach for this study.

3.5.3.3 Literal, Golden and Mischief Rule

Literal Rule determines the intention of the legislature for introducing a law from words and expressions utilised as part of the assemblage of law; Golden Rule is utilised where the outcome of literal interpretation is evidently irrational and its investigation provides inadmissible outcomes; Mischief rule permits wide understanding of the words and expressions utilised as a part of statutes.

This research does not include the interpretation of any Act of Parliament or legislation therefore; there is no need to apply Literal, Golden and Mischief Rules. This study analyses the CCG, and for this purpose, an interpretative research philosophy facilitated to get the answer of research question.

3.6 Trustworthiness of Qualitative Research

All research studies are open to criticism and evaluation generally.⁶⁰ A study could have dire consequences if its worth could not be assessed, the methods employed to carry out this study are not accurate and reliable, and its findings and conclusions do not have any impact or contribution in existing knowledge. Confusing or pointless conclusion of a study may result in wasted time and effort. However, wrong findings can have harmful and dangerous consequences.

⁵⁹ Legal Information Institute, <http://www.law.cornell.edu/wex/black_letter_law> accessed 10 January 2015

⁶⁰ Andrew Shenton, 'Strategies for Ensuring Trustworthiness in Qualitative Research Projects' (2004) 22 Education for Information 63, 64

Therefore, the criticism and evaluation of studies is inevitable for the application of its findings.⁶¹ Conventionally, such evaluation is conducted by assessing the validity and reliability of the methods used to carry out the study. The following sections define both of these terms, their purpose and usage in qualitative studies and then establish the trustworthiness of this thesis.

3.6.1 Validity and Reliability

Though the term ‘Reliability’ is primarily used in quantitative research however, the underlying idea is utilised in all types of research for analysis and assessing purposes. Therefore, the most significant check of any qualitative study is its quality. A good qualitative study can lead us to comprehend a mysterious or ambiguous situation easily that would not have been possible otherwise.⁶² This idea narrates the quality research; while reliability is a notion used to assess quality in quantitative research with the intention of elucidation; however the idea of quality in qualitative study intends to generate understanding’.⁶³ This difference of purposes in the evaluation of quality in qualitative and quantitative studies leads to the concept of reliability irrelevant rather misleading in qualitative research.⁶⁴

An alternative view is that the validity and reliability are two elements which should be considered by qualitative researchers at the time of designing a study, evaluating and outcomes.⁶⁵ This apprehension leads to a question that how can an inquirer convince his/her readers that the results of his/her research are important to be considered?⁶⁶

⁶¹ Ibid

⁶² Elliot Eisner, *The Enlightened Eye: Qualitative Inquiry and the Enhancement of Educational Practice* (Macmillan Publishing Company 1991) 58

⁶³ Caroline Stenbacka, ‘Qualitative Research Requires Quality Concepts of its Own’ (2001) 39(7) *Management Decision* 551

⁶⁴ Ibid

⁶⁵ Ibid (n 34)

⁶⁶ Yvonna Lincoln and Egon Guba, *Naturalistic Inquiry* (Beverly Hills CA: Sage 1985) 290

To answer this question, Healy and Perry⁶⁷ stress that the quality of a study should be assessed by using the terms of its own paradigm. Such as, in quantitative inquiries, the terms reliability and validity are considered vital standard for judging the quality of study; however in qualitative paradigms the terms consistency, dependability, credibility, conformability, neutrality, transferability and applicability are considered necessary criteria for judging the quality.⁶⁸ In order to be more specific with the terms, ‘dependability’ is used in qualitative research interchangeably which is narrowly related to the concept of ‘reliability’ in quantitative research.⁶⁹

The following table 3.4 shows the different criteria of judging the trustworthiness of a study in qualitative and quantitative studies. Clont⁷⁰ and Seale⁷¹ also validate the notion of dependability in qualitative research with the notion of reliability in quantitative research. The reliability and uniformity of data can be attained only if the stages of research are followed appropriately from identifying a research problem to find its solution by conducting a thorough investigation.⁷² Therefore, the investigation of trustworthiness is critical in order to confirm reliability in qualitative research.

Stenbacka⁷³ claims that though reliability issue relates to measurements therefore, it is not relevant in qualitative research. She further argues that in evaluating the quality of qualitative studies the issue of reliability is irrelevant. Therefore, the study conducted considering reliability would not be considered a good study. Lincoln and Guba⁷⁴ bring the usage of both terms together by arguing that though validity and reliability are interconnected and there can be no validity without

⁶⁷ Marilyn Healy and Chad Perry, ‘Comprehensive Criteria to Judge Validity and Reliability of Qualitative Research within the Realism Paradigm’ (2000) 3(3) Qualitative Market Research 118

⁶⁸ Ibid

⁶⁹ Ibid (n 67) 120

⁷⁰ Jean Clont, ‘The Concept of Reliability as it Pertains to Data from Qualitative Studies’ (1992) Paper presented at the annual meeting of the South West Educational Research Association Houston TX

⁷¹ Clive Seale, ‘Quality in Qualitative Research’ (1999) 5(4) Qualitative Inquiry 465

⁷² Trudy Campbell, ‘Technology, Multimedia and Qualitative Research in Education’ (1996) 30(9) Research on Computing in Education 122

⁷³ Ibid (n 63) 552

⁷⁴ Ibid (n 66) 290

reliability, therefore to establish one of them should be enough to judge the quality of a study.

In qualitative studies, the notion of validity is described by various terms. Creswell and Miller⁷⁵ argue that it is the researcher's perception that affects the validity of a study. Consequently, numerous researchers have established their own ideas of validity in the form of terms such as, rigor, quality and trustworthiness; and they chose among them which they consider fit for their respective study.⁷⁶

The tradition of validity and reliability in quantitative studies originated this concern in qualitative studies too in order to reflect interpretivist (qualitative) conceptions.⁷⁷ In qualitative studies, the criterion to evaluate quality is substituted by the idea of trustworthiness,⁷⁸ in order to establish confidence in the findings; instead of validity and reliability.⁷⁹ If the concerns of trustworthiness, validity, reliability, quality and rigor are intended to distinguish good quality and bad quality research then the measurement of these notions will be significant for research. The quality of a research ensures the generalisability of its result which ultimately justifies and enhances the validity or trustworthiness of the research. If the validity or trustworthiness of a study can be verified and enhanced; its results will be more generalisable and will be declared more credible.

Some qualitative researchers reject the notion of validity due to their philosophical perspectives which are normally acknowledged in more quantitative research in the social sciences. These qualitative researchers promote diverse principles for assessing the value of research. For example, Lincoln and Guba⁸⁰ projected four measures to evaluate the truth of qualitative research and presented

⁷⁵ John Creswell and Dana Miller, 'Determining Validity in Qualitative Inquiry' (2000) 39(3) Theory into Practice 124

⁷⁶ Deirdre Davies and Jenny Dodd, 'Qualitative Research and the Question of Rigour' (2002) 12(2) Qualitative Health Research 279

⁷⁷ Ibid

⁷⁸ Nahid Golafshani, 'Understanding Reliability and Validity in Qualitative Research' (2003) 8(4) The Qualitative Report 597

⁷⁹ Ibid (n 75) 127

⁸⁰ Ibid (n 66) 292

them as a substitute to the conventional quantitative measures. According to them their alternative four measures better reflected the fundamental norms involved in qualitative studies. The following table shows their proposed criteria.

Table 3.4: Different Terms Used for Judging the Trustworthiness in Qualitative and Quantitative Research⁸¹

Conventional Standards for Assessing Quantitative Research	Alternative Standards for Assessing Qualitative Research
Internal validity	Credibility
External validity	Transferability/Applicability
Reliability	Dependability/ Consistency
Objectivity	Conformability/Neutrality

Qualitative research is based on the presumption that every researcher comes with a distinctive viewpoint to his/her study. The researcher can have a record and document the processes for examining and re-examining the data during the study; and another researcher (can be a friend or supervisor) can corroborate his findings, and this procedure can be recorded. The researcher can also describe adverse instances that contradict prior observations. In the end, data audit can be conducted to investigate the data collection and analysis measures and draws conclusions about the prospective prejudice.

3.6.2 Trustworthiness of this Study

The researcher submits that the notions of validity and reliability are quite confusing (as discussed above), as some researchers consider these terms valid for quantitative studies only, however others consider them valid for qualitative studies as well. Even those who consider the validity and reliability important for qualitative studies are divided in two groups: those who think these terms (validity and reliability) as it is important for qualitative studies; and those who consider them with different terminologies such as credibility, dependability and so on and

⁸¹ Adapted from <www.socialresearchmethods.net/kb/qualval.php> accessed 20 June 2015

so forth. However, the basic idea according to this researcher is same, and that is to establish the scope, significance and trustworthiness of research.

The researcher further submits that the truth of a research can be established by making a good research design of a study showing a consistent research process followed by findings/recommendations which could be generalised and could contribute in existing knowledge. Moving a step further, in order to check the rigour of those recommendations, they can be peer reviewed by another researcher who can be a supervisor as well.⁸²

This process has been followed throughout in this study. A research problem having a significant scope (established in chapter one) has been identified in order to conduct this study. The valid and credible sources have been used to collect data. The whole study including its results/recommendation has been passed through peer reviewed process that is double checked by my supervisor throughout this journey in order to check its rigour and trustworthiness.

Sources used in this study are comprised of provisions of CCG, which demonstrate the ‘will’ of regulators and authorities. Similarly, sources include governmental policies, decisions promulgated by the government of Pakistan (GOP), reports published by GOP and international organisations such as UN, IFC, UNEP FI, and OECD, SECP’s policies, reports and decisions, official documents, companies’ annual reports. Therefore, any factors of researcher’s bias or credibility of data collected through these methods is unlikely.

The application of aforementioned un-rebutted tools of legal research sufficiently validates the contemporary research. To investigate the impact of CCG on the corporate sector of Pakistan, the working and effectiveness of BODs and the role of IIs has been explored in the country. The outcome of this study provides recommendations which can be proved as guidelines to the SECP and government authorities to modify the CCG and to provide protection to IIs. This research may also be proved as a parameter for companies and investors to make considerable

⁸² Ibid (n 67, 71)

changes in their working strategies which would ultimately improve the CG practices in Pakistan. Every finding and recommendation provided in this study is supported by valid evidence which confirms the credibility of this research work.

3.7 Ethical Consideration

The sources used in this research are publicly available on the official websites of investee companies and the government institutions such as, SECP, OECD, FRC, KSE, and LSE. Therefore, there was no need to have some special ethical considerations regarding the privacy and anonymity of documents. Furthermore, as this study is not empirical in nature, hence, there are no ethical considerations required to be considered related to the privacy of persons or of data. Moreover, the sources and data used in this study is properly referenced and acknowledged according to the regulations which fulfil the ethical requirements of this research.

3.8 Conclusion

This chapter has specified the means through which the objectives of this study have been addressed. It has presented the methods and methodologies employed in this study in detail. It has explained the research philosophy, research approach, research strategies and a brief description of research design of this study. This chapter further described and validated the data collection and analysis techniques and processes that have been utilised during the course of this study.

In short, this study is socio-legal. It employs qualitative method of research using exploratory and descriptive approach with interpretative philosophy and inductive research approach. Data is collected through both primary and secondary sources. Analysis of data is conducted through content analysis and interpretative methods. The rationale behind choosing some particular methods and methodology is explained and justified in detail in this chapter along with the explanation and justification of reasons for rejecting others. The truth and rigour (validity and reliability) of this study, data collection and analysis is also established in this chapter.

The next chapters from four to seven are core chapters of this thesis. Each chapter deals with a research objective of this study. The next chapter deals with the first objective of this thesis.

CHAPTER FOUR: THE FRAMEWORK OF PAKISTAN'S CORPORATE GOVERNANCE

4.1 Introduction

The previous chapter has presented the research methodology deployed for this study. This chapter deals with the first objective of this thesis. Its aim is to analyse the code of corporate governance (CCG) of Pakistan, identify its weaknesses and make recommendations to develop a new more effective and efficient CCG for the listed companies of Pakistan considering the particular corporate environment of country. For this purpose, the current chapter first provides the development and nature of corporate governance (CG) in Pakistan in order to understand that how old CG principles are in Pakistan and how CG works in Pakistan. Then, it moves on to examine the provisions of CCG, identifies its weaknesses and provides recommendations. In the end, a brief conclusion is presented in section 4.5. The following figure presents the plan of this chapter.

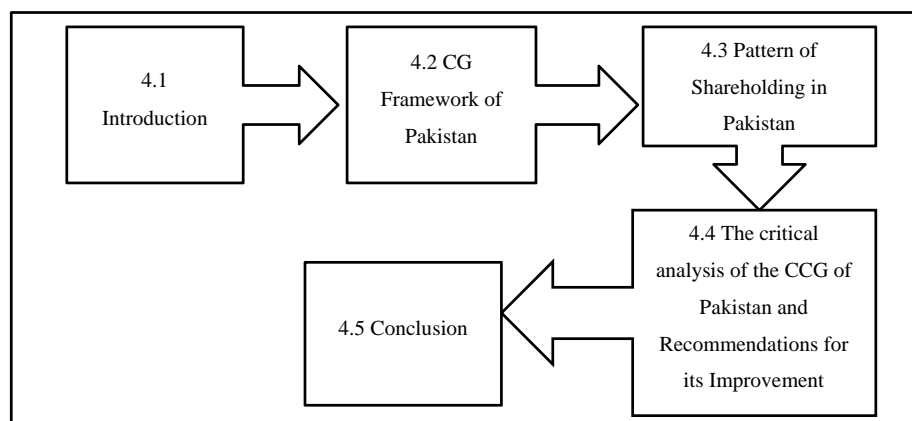


Figure 4.1: Plan of this Chapter

4.2 Corporate Governance Framework of Pakistan

The corporate sector of Pakistan had also seen a number of corporate disasters like rest of the world; NICL, PTCL, PR, NPP, PIA,¹ Mehran Bank and other several finance companies have destroyed the life-savings of thousands of small investors.² Nationalised banks have disregarded billions of rupees by way of bad loans, in the recent past.³ These scams are similar to those occurring across borders especially in the US.⁴ The prey in majority of cases being the common men led to a public outcry over companies' management and regulations.⁵ Resultantly, financial experts decided to discover the solution similar to medical profession: 'prevention is better than cure'.⁶ Thus the term CG evolved.

The principal source of CG in Pakistan is Company Law. Pakistan's company law⁷ is based on colonial company law⁸ announced before independence for British India.⁹ The first CCG in Pakistan was formulated by the Institute of Chartered Accountants of Pakistan (ICAP) in 1998. The Securities and Exchange Commission of Pakistan (SECP) issued this CCG in 2002. The Companies Ordinance of 1984 and the Banking Companies Ordinance of 1962 also covers the principles of CG. Presently, CG consists upon two bodies: the SECP and the State Bank of Pakistan (SBP),¹⁰ as discussed in section 1.2.

¹ They all are discussed in section 1.2.1

² Adnan Ibrahim, 'Corporate Governance in Pakistan: Analysis of Current Challenges and Recommendations for Future Reform' (2006) 5(2) Washington University Global Studies Law Review 323

³ Waqar Ghani and Junaid Ashraf, 'Corporate Governance, Business Group Affiliation, and Firm Performance: Descriptive Evidence from Pakistan' (2005) Centre of Management and Economic Research Working Paper Series 05-35, Lahore University of Management Sciences 19

⁴ Syeda Shabbir, 'The Role of Institutional Shareholders Activism in the Corporate Governance of Pakistan' (2012) 1(2) Journal of Humanities and Social Sciences 1, 3

⁵ Steven Bainbridge, *The New Corporate Governance in Theory and Practice* (Oxford University Press New York 2008) 6

⁶ Ibid

⁷ The Companies Ordinance 1984 (the Ordinance 1984)

⁸ The Indian Companies Act 1913

⁹ The subcontinent including Pakistan, India and Bangladesh; Nazir Shaheen, *Practical Approach to the Companies Ordinance, 1984* (4th edition, Federal Law House Rawalpindi 2011) 2

¹⁰ Shah Nawaz Mahmood and Nadeem Shaikat, *The Company Law* (Legal Research Centre Pakistan 2010) "See generally"

The SECP was established in 1997, is the primary regulator and responsible for the implementation of CCG. The SECP is mainly an autonomous body works under the control of Ministry of Finance (MOF) and controls the corporate matters of companies, non-banking financial institutions and capital markets. The MOF holds the power to select the commissioners of SECP, who are normally best experts engaged in business sector and large number of them originate from private division.¹¹

The SECP implements the listing rules for the three stock exchanges of Pakistan: the Karachi Stock Exchange (KSE), the Lahore Stock Exchange (LSE), and the Islamabad Stock Exchange (ISE). As the clauses of CCG are integrated in the listing rules, the SECP guarantees the adoption of those requirements.¹² The SBP is Pakistan's national bank and is in charge of controlling the banking and financial sector of Pakistan. The SBP is empowered to implement CG standards in banks.

However, along with the defiance of CCG, banks have to observe additionally the Prudential Regulations of the SBP and the Banking Ordinance of 1962. Nevertheless, guidelines for banks are more hard and detailed in contrast to those for other listed companies and are beyond the scope of this research. To put it plainly, the elements in charge of the execution and administration of CG in Pakistan are MOF, SECP and SBP.¹³

The CCG consists upon the principles of best practices intended to provide a mechanism in order to direct and control companies listed on stock exchanges of Pakistan. The objective of CCG is to protect stakeholders' interests and promote market confidence which ultimately improve the performance of companies. For this purpose, the CCG got the experience of other jurisdictions in formulating CG models, particularly from common law countries having similar tradition like

¹¹ Faryal Salman and Kamran Siddiqui, 'Corporate Governance in Pakistan: From the Perspective of Securities and Exchange Commission of Pakistan' (2013) 12(4) The IUP Journal of Corporate Governance 13, 15; The information is also available on the website of SECP <www.seco.gov.pk>

¹² Haroon Hamid and Valeria Kozhich, 'Corporate Governance in an Emerging Market: A Perspective on Pakistan' (2006) 1(1) Journal of Legal Technology Risk Management 1, 3

¹³ Ibid

Pakistan's,¹⁴ such as the UK and South Africa.¹⁵ In this respect, the proposals of the King's Report (South Africa), the Code of Best Practice of the Cadbury Committee on the Financial Aspects of CG published in December 1992 (UK), the Report of the Hampel Committee on CG published in January 1998 (UK), and the Principles of CG published by the OECD in 1999 were significant documents.¹⁶

Corporate entities are principally controlled by the SECP under the Securities and Exchange Ordinance, 1969, the Companies Ordinance, 1984, the SECP Act, 1997, and the several other rules and regulations made thereunder. Moreover, in addition to the SEC, special companies might additionally be controlled by special laws and by other regulators.¹⁷

Thus, listed companies are also regulated by their respective stock exchange at which they are listed; banking companies are also regulated by the SBP; companies involved in providing telecommunication facilities are additionally controlled by the Pakistan Telecommunication Authority (PTA); companies involved in the generation, transmission or distribution of electric power are further controlled by the National Electric Power Regulatory Authority (NEPRA); and oil and gas companies are also controlled by the Oil and Gas Regulatory Authority (OGRA).

This list is just for explanation and not comprehensive. Moreover, each company has its own constitution in the form of Memorandum of Association (MOA) and Articles of Association (AOA), according to which that company is bound to operate its business. There is general specimen of MOA and AOA is provided by SECP on its website, companies can adopt that as it is or may adopt it by making some changes according to their respective businesses.

¹⁴ Rashid Amjad, *Private Industrial Investment in Pakistan, 1960-1970* (Cambridge University Press 1982) 5

¹⁵ Although South Africa has a hybrid legal system which is a mixture of three systems: the civil law (inherited from Dutch), the common law (inherited from the Britain) and the customary law (inherited from indigenous Africans).

¹⁶ Ibid (n 12) 4

¹⁷ Ali Cheema *et al.*, 'Corporate Governance in Pakistan: Ownership, Structure and Control' (2003) Lahore University of Management Sciences Paper Series 11, 13

4.3 Pattern of Shareholding in Pakistan

This section describes the nature of corporate framework in Pakistan. The following figure shows the shareholding patterns in Pakistani companies, and the length of arrows points out the higher and lower number of shareholding.

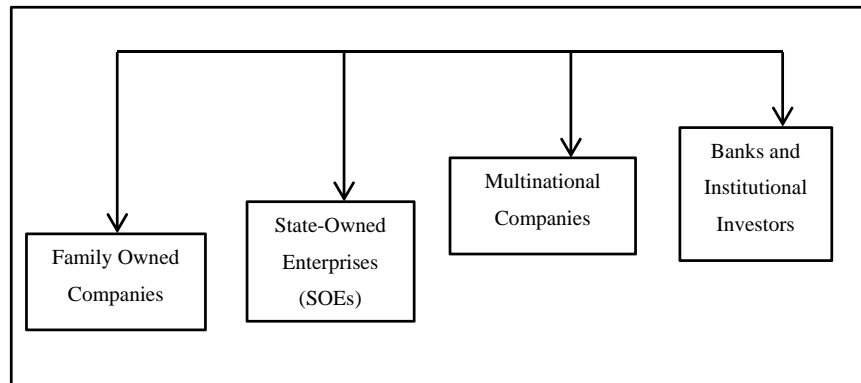


Figure 4.2: Shareholding Patterns in Pakistan¹⁸

The corporate structure of Pakistan is exceptionally concentrated, with families-owned companies/enterprises (FOEs) and State-Owned Enterprises (SOEs). Families are prevailing in the corporate framework both in private and public companies of Pakistan.¹⁹ By more than 50 per cent²⁰ of privately owned businesses are controlled by two individuals the vast majority of whom are spouses keeping in mind the end goal to accomplish the basic condition of individuals for a privately owned business under the Companies Ordinance 1984.²¹

Families and certain group of people grasp more than 75 per cent of shareholding in the listed companies of Pakistan which is more than the lowest prerequisite in order to take decisions in the meetings.²² This limit is dissimilar from the UK

¹⁸ Developed by the researcher

¹⁹ Awais Gulzar and Zongjum Wang, 'Corporate Governance and Non-Listed Family owned Businesses: An Evidence from Pakistan' (2010) 1(2) International Journal of Innovation, Management and Technology 124, 125

²⁰ Ibid (n 3)

²¹ Ibid (n 3)

²² Moin Fudda, 'Corporate Governance in Family-Owned Companies in Pakistan' (2014) CIPE 1 <www.cipe.org/publications/detail/corporate-governance-family-owned-companies> accessed 10 March 2015

where it is mandatory requirement that 25 per cent shareholding must be held by the general public under the listing rules with the end goal of an active and dynamic market. However, there is no such condition in Pakistan and families and some certain groups hold majority of shareholding to have controlling authority in their hands. The combined voting might permit minority shareholders or individual investors to choose directors to the board of directors (BODs) however due to the concentration of large portion of shareholdings in selected hands do not let minority representatives to be elected on the BODs.²³

The families own the majority of listed companies and strengthen their control either specifically by owning the larger part of shares or by indirect methods such as pyramiding, cross-shareholding or interlocking management. According to the antitrust legislation,²⁴ interlocking directorship/management is not unlawful if the respective companies do not have a competition among themselves.

The researcher asserts that the families hold the majority of shareholdings in order to keep control of companies which generates a liquidity issue in the business market. Cross shareholding, Pyramiding and interlocking are complex phenomena hard to understand for common investors. These families likewise keep up their control by naming their relatives as executive and non-executive members on BODs or at least some persons in their confidence and these individuals usually do not have required capabilities and experience. These family members take most of the significant policy decisions without formally setting off to meeting of the BODs or of the investors. This concentration of control is kept up for the sole purpose of getting secretive advantages and to keep trade stream out their own particular hands and to control the BODs and administration of the company.²⁵

²³ Ibid (n 19)

²⁴ In Pakistan the Antitrust Law is called 'The Competition Act of 2010' which although does not contain exact provision on interlocking- management; however section 3 of the Act prohibits any act, practice or abuse of power which restricts or distorts fair competition in the relevant market.

²⁵ Attiya Javid and Robina Iqbal, 'Corporate Governance in Pakistan: Corporate Valuation, Ownership and Financing' (2010) PIDE Working Papers 2010: 57, 12
<<http://pide.org.pk/pdf/Working%20Paper/WorkingPaper-57.pdf>> accessed 20 December 2015

The state is the biggest partner after families. The SOEs are both listed and non-listed. Similarly, among the best forty listed companies at the KSE, fourteen are owned by the state. The SOEs represent 52.8% of the aggregate capitalisation of the main forty companies listed on KSE.²⁶ The SOEs are politically driven and each government in the wake of coming into power holds the control of these companies. The administration, management and directors of BODs of these companies stay in such positions at the delight of the state. The criteria for the appointments on BODs is political alliance of the individuals instead the experience, skills, abilities and qualification.

The researcher submits that the FOEs and SOEs are significant foundations for corporate development in Pakistan but control maximisation is a big hindrance for this development. The strong control by families and state of public companies is a genuine administration issue.²⁷ They oppose changes and development of CG principles additionally intimidates to delist their companies. However, there was considerable delisting after the proclamation of the CCG in 2002. Many smaller companies and FOEs do not have awareness regarding the probable advantages of developed CG.²⁸

The SECP established Pakistan Institute of Corporate Governance (PICG) for the purpose of enhancing awareness among business community about the advantages to adopt and implement CG principles in their respective companies. The PICG has trained 450 individual so far to perform this task, among them 240 have been given certification of CG. The PICG also encourages business schools to include CG in their syllabus as a subject and teach CG principles and their benefits to business students.²⁹ However, there are a lot still needs to be done on this, as these measures are still just in theory, we cannot see their considerable practical impact on business community so far.

²⁶ Ibid (n 11) 15

²⁷ The examples of such control resulting in bad governance is provided in section 1.2.1

²⁸ IMF Report on the Observance of Standards and Codes (ROSC)

²⁹ Faryal Salman and Kamran Siddiqui, 'Corporate Governance in Pakistan: From the Perspectives of Pakistan Institute of Corporate Governance' (2013) 12(4) The IUP Journal of Corporate Governance 17, 20

Moreover, dispersed ownership³⁰ is a rare and recent phenomenon in Pakistan. The state in the twentieth and early twenty first century divested its shareholdings to the general public. This trend attracted some FOEs and multinational companies³¹ who issued shares to the general public. This created a public shareholding in the corporate market. However, its ratio of shareholding is very small compared with the shareholdings owned by family members in FOEs, the state in SOEs and management in multinational companies. The government is now planning to divest twenty six per cent of its shareholding in eighty SOEs and twelve per cent will be issued to the employees.³² This will further increase the ratio of dispersed ownership in the corporate structure.

The multinational companies (MCs) are the third significant partner in the business sector of Pakistan. Among the main forty listed companies at KSE, there are five MCs which constitute seventeen per cent capitalisation in the top forty listed companies at KSE.³³ The existence of foreign companies in the corporate sector of Pakistan is a good indication for the economic development of the country, as these MCs are a noteworthy cause of foreign direct investment (FDI) in Pakistan.

Moreover, MCs are more concerned about the implementation of CG principles in their businesses and are well-known about being transparent about their dealings, and show high standards of governance. The top MCs working in Pakistan are Unilever, Proctor & Gamble, Nestle, Chartered Bank, Siemens, Toyota, Pepsi Cola International, Mobilink and ICI (Imperial Chemical Industries). The business of ICI is industrial, decorative, refinish and speciality chemicals. Their

³⁰ John Cubbin and Dennis Leech, 'The Effect of Shareholding Dispersion on the Degree of Control in British Companies: Theory and Management' (1983) 93 *The Economic Journal* 355

³¹ The multinational companies are those companies who are registered as domestic company as subsidiary companies of overseas holding companies according to the companies ordinance 1984.

³² *Ibid* (n 12) 5

³³ Cheema *et al.*, 'Corporate Governance in Pakistan: Issues of Ownership, Control and the Law' in Farooq Sobhan and Wendy Werner (eds), *A Comparative Analysis of Corporate Governance in South Asia: Charting a Road Map for Bangladesh* (Bangladesh Enterprise Institute, Dhaka 2003) "See generally"

slogan is colouring Pakistan and they give preference to health, safety and environmental betterment.³⁴

The existence of MCs in Pakistan and their governance standards give incentives to local business community to improve governance standards in their respective companies and to take CCG seriously. This additionally inspires and influences the state to play its part in improving the whole CG framework with a strong regulator. The researcher submits that the FDI can further be increased if CG is improved. These companies can be a good precedent for local companies for governance observation. The MCs are from those countries which have firm disclosure requirements and established governance frameworks, consequently these MCs can be as a model and source of inspiration for local companies in regards to disclosure, transparency, administrative and other governance issues.³⁵

The researcher further asserts that the banks and institutional investors (IIs) are other substantial shareholders in Pakistan's corporate sector but they have a minor role in CG. The IIs are represented on BODs and banks give proper representation to IIs on their BODs. However, the role and representation of IIs is limited in Pakistan and they are not playing their role in the growth of CG. There is a need for the role of IIs to be activated and maximised, as they can play a considerable part in developing the CG norms in the country being experienced, highly skilled and being influential due to their large shareholdings. They can convince the BODs and management about adopting the good CG principles through a number of ways.³⁶

4.4 The Critical Analysis of the CCG of Pakistan and Recommendations for its Improvement

Good governance helps in achieving the confidence of investors and the governance practices influence the investment decisions of both local and foreign

³⁴ The information is collected from the website of ICI <www.ici.com.pk> accessed 1 June 2015

³⁵ Ibid (25, 33)

³⁶ It is one of the objectives of this thesis to explore the role of IIs in promoting CG in Pakistan and is discussed in chapter seven in detail.

investors. Companies have to adopt enhanced CG standards in order to compete globally. This is one of the major reasons to make capital markets transparent, safeguarding the interests of shareholders and drawing foreign investment. The CG is significant for both purposes; business prosperity and accountability. Therefore, the SECP endeavours to elevate the CG standards of the country.³⁷ The first major step in this was the compilation and issuance of the first CCG in 2002.³⁸

The CCG established a structure adjusted to deal with the complexities of the Pakistan's corporate sector and furthermore compiled the CG best practices as exemplified in different noticeable international models of CG.³⁹ The adoption of CCG was obligatory for listed companies aside from two that were voluntary. The following table shows the mandatory and voluntary provisions of the CCG 2002.

Table 4.1: Mandatory and Voluntary Provisions of the CCG 2002⁴⁰

Clause	Description	Nature
(i)	Representation of INEDs, including those representing minority interests on the BODs of listed companies.	Voluntary (V)
(v)	Election/ nomination of a broker on the BODs	V
(ii)	Filing of consent by directors	Mandatory (M)
(iii) and (iv)	Qualification and eligibility for directors	M
(vi)	Tenure of office of directors	M
(vii), (viii) and (ix)	Responsibilities, powers and functions of BODs	M
(x), (xi) and (xii)	Meetings of BODs	M
(xiii)	Significant issues to be placed for decision by BODs	M
(xiii) (a)	Related Party Transactions	M

³⁷ Mr Muhammad Ali, The former Chairman of the SECP.

³⁸ As discussed earlier.

³⁹ Ibid 12; Qaiser Yasser, 'Corporate Governance and Performance: A Case Study for Pakistani Communication Sector' (2011) 2(3) International Journal of Trade, Economics and Finance 1

⁴⁰ <http://www.secp.gov.pk/cg/codeofcorporategovernance_2002.pdf> accessed 20 November 2015

(xiv)	Orientation courses	M
(xv)	Appointment and removal of CFO and Company Secretary (CS)	M
(xvi) and (xvii)	Qualification of CFO and CS	M
(xviii)	Requirement for CFO and CS to attend Board meetings	M
(xix)	The directors' report to shareholders	M
(xx), (xxi), (xxii) and (xxiii)	Frequency of financial reporting	M
(xxiv) and (xxv)	Responsibility for financial reporting and corporate compliance	M
(xxvi)	Disclosure of interest by a director holding Company's shares	M
(xxvii)	Auditors not to hold shares	M
(xxviii)	Corporate ownership structure	M
(xxix)	Divestiture of shares by sponsors/ controlling Interest	M
(xxx), (xxxi), (xxxii), (xxxiii) and (xxxiv)	Audit Committee	M
(xxxv) and (xxxvi)	Internal Audit	M
(xxxvii), (xxxviii), (xxxix) and (xI)	Appointment of external auditors	M
(xIi)	Rotation of external auditors	M
(xIii)	Appointment of a partner or employee of the external auditors in a key position within the listed company	M
(xIiii)	Management letter issued by external auditors	M
(xIiv)	Attendance of external auditors at AGM	M
(xIv) and (xIvi)	Compliance with the CCG	M

The table shows that all provisions of CCG 2002 were mandatory except two; however this researcher submits that voluntary provision relating to the representation of INEDs should be mandatory in nature not voluntary. The reason is that the objective of appointing independent director on BODs is to monitor the actions, strategies and decision-making of BODs. However, in Pakistan the office

of independent NED director is considered simply as an honorary position. That's why perhaps required importance is not given to this office.

Secondly, although the CCG was included in the listing requirements for listed companies and most of its provisions were mandatory, the compliance could not be seen satisfactorily primarily due to non-serious attitude of government,⁴¹ vested interests of families owning large number of companies⁴² and many other factors.⁴³

Therefore, the researcher argues that, the strong enforcement mechanisms of the country are much necessary. The issuance of CCG is a big step and good effort on the part of SECP for enhancing good governance practices in the listed companies of Pakistan; but there is no use of this CCG if it cannot be implemented in its true spirit. Thirdly, it seems that while drafting the CCG, other corporate laws of the country have not been considered or cross-checked, because some provisions of the CCG overlaps with other corporate laws.

For example, the CCG 2002 puts this mandatory obligation on the chairman of the listed company to guarantee that the minutes of the BODs meetings are documented appropriately.⁴⁴ On the other hand, section 173(1) of the Ordinance,⁴⁵ puts this responsibility on company itself to maintain proper record of the minutes of AGM proceedings, but do not clarify that what does it mean by 'company' as company is a legal entity which is run by different offices, and the provision of Ordinance does not clarify that which office of the company is responsible to perform this function.

However, the CCG 2012 uses the word 'The Chairman' to perform this function.⁴⁶ This confusion causes a problem to carry out the most important task of recording minutes of BODs meetings. Secondly, to follow the provisions of Ordinance is

⁴¹ As established in section 1.2.2

⁴² See section 1.2.2

⁴³ These factors are identified in section 5.3.

⁴⁴ Clause (xii) of the CCG 2002

⁴⁵ Section 173(1) of the Companies Ordinance 1984

⁴⁶ Clause (viii) of the CCG 2012

mandatory and in case of violation the violator/s has to pay penalty; on the other hand compliance with the CCG is also mandatory. In such situation, insiders (executive directors) consider it their discretion to use these provisions for their benefits. The regulators and policy makers should consider about such overlapping provisions seriously, as meetings of BODs decide the fate of a company and thus, shareholders' destiny is also decided by them. Therefore, there should be a consistent procedure clearly defined in all corporate laws and principles to record the meetings of BODs appropriately.

Moreover, according to the Ordinance⁴⁷ an individual cannot be a director of a listed company who himself or his/her partner is involved in the trade of brokerage as a member of the stock exchange. Conversely, the CCG 2002⁴⁸ does not debar such person to be a director of a listed company if he gets immunity from SECP. However, the new CCG 2012 is silent on this matter. In such situation, the CCG itself providing opportunity to the individuals having vested interests, they can get exemption from SECP and can be involved in company's matters.

Here the counter argument can be that, the SECP is the regulator of CCG, therefore SECP may not provide an exemption if it thinks that such exemption will be harmful in the interests of shareholders. The answer to this argument can be seen in two ways; one such person having bad intentions can get exemption by using their political and other connexions as it is the MOF who appoints commissioners of SECP and secondly, how SECP can take stand and refuse to give exemption if it provides relaxation itself in the CCG. In this situation where does lie the position of Ordinance, whose violation initiates procedures in court of law? The researcher submits that law and rules should be free from such ambiguities and the policy makers in Pakistan should consider this seriously if they wish to develop CG practices in true sense.

⁴⁷ Section 187(j) of The Companies Ordinance 1984

⁴⁸ Clause (v) of the CCG 2002

Furthermore, the Ordinance provides that,⁴⁹ any stakeholder (director, CEO or executive) of a company⁵⁰ retaining equity securities more than ten per-cent as favourable holder of a listed company is under obligation to prepare a report of any profit s/he gets from the trade of these securities within six months. Moreover, such person is additionally under obligation to declare that gain to the company and indicate this to the Registrar⁵¹ and the Commission.⁵² However, the CCG⁵³ provides that such person making any gain shall immediately notify the CS in writing and will furthermore provide the documented record of the cost and amount of shares within four days of such transaction. Then it is the responsibility of the CS to document and present it before the BODs in its next meeting.

In this case, the CCG provides clearer and stricter provisions to be carried out; however, the Ordinance is giving relaxation by providing a long time of six months to disclose about any gains made by the stakeholder of a company. Six months is quite enough time for a person to make gains on the shares of a company and then dispose of its record. These overlapping provisions of the Ordinance and the CCG creates misperception as to follow the Ordinance is mandatory for all companies and breaking of this involves application of penalty (as mentioned above also) however, the SECP additionally demands thorough adoption of the CCG from listed companies. Consequently, the owners of the business chose and adopt the provision according to their benefits which does not set a good example for virtuous CG practices.

Such conflicting and ambiguous provisions of laws make their implementation even more difficult. There should be uniform laws to be followed by every company to make them more effective and efficient and to assess the ratio of their implementation and enforcement. As to measure the proper implementation of laws come later, first the laws itself should be effective enough that companies

⁴⁹ Section 224 of the Companies Ordinance 1984

⁵⁰ Including directors, officers, major shareholders etc.

⁵¹ Registrar means the Registrar performing the function of registering companies under the Companies Ordinance 1984.

⁵² Here Commission means the Securities and Exchange Commission of Pakistan.

⁵³ Both CCG; clause (xxvi) of the CCG 2002 and clause (xxiii) of the CCG 2012

could follow them without being confused and picking the provisions of their own choice.

Nevertheless, though the CCG has not been implemented fully, the performance of corporate sector has improved due to its introduction in terms of accountability and transparency. However, the policy makers should apply regulatory impact assessment (RIA) more rigorously which will improve accountability on the part of regulators as well and it will also improve transparency.⁵⁴

The CCG 2002 was replaced with the CCG 2012, which has also been included in the relevant Listing Regulations. The revised CCG emphasise the importance of independent directors on the BODs and makes one independent director mandatory however, 1/3rd independent directors of the total members of the BODs is preferred.⁵⁵ However, the researcher argues that this number of independent directors should be increased on BODs to at least fifty per cents to ensure stricter monitoring of BODs in order to achieve more accountability and transparency. Secondly, PICG should also work on creating awareness among business community that the purpose of appointing NEDs on BODs is not just to honour your friends and family with directorship rather NEDs should independent individuals who could monitor the actions, strategies and decision-making of BODs.

Moreover, the total number of directorships that an individual can have at a time is reduced to seven from ten, however there is no limit of having directorship in the listed subsidiaries of a listed holding company⁵⁶ The researcher submits that the underlying idea of this reduction in the number of directorships may be to decrease the work load on a director so that s/he could do justice with his/her responsibilities towards companies. For this purpose, this number should be reduced more as holding the office of director in seven companies is still over-

⁵⁴ Rasul Rais and Asif Saeed, 'Regulatory Impact Assessment (RIA) of SECP's Corporate Governance Code in Pakistan' (2004) CMER Working Paper No. 05-39
<http://saber.eaber.org/sites/default/files/documents/LUMS_Rais_2005.pdf> accessed 20 June 2015

⁵⁵ Clause (i) (b) of the CCG 2012

⁵⁶ Clause (ii) of the CCG 2012

burdening. A person cannot do justice with any one of company's matters if he has too many responsibilities of various companies.

This interlocking directorate is quite an old phenomenon and common among corporations.⁵⁷ However the statutory attempts have been taken to minimise this practice. Companies may gain benefits that reduce environmental uncertainty through interlocking i.e., horizontal organisation which links competitors; vertical harmonisation which associates an organisation with contractors of inputs or receivers of outputs; skill and higher reputation.⁵⁸ However, antitrust legislation surmises that establishing and maintaining uncertainty in a marketplace via competition is a social good however, decreasing this uncertainty by way of interlocking could be a profit-enhancing strategy for the benefit of firms and their shareholders.⁵⁹

The antitrust legislation in Pakistan is called 'The Competition Act of 2010'. Section 3 of the Act forbids the misuse of any leading position through the acts that limits or misrepresents competition in the respective market. However, the application of this Act does not seem to be effective so far, as the practice of interlocking management prevails and is misused in Pakistani companies particularly in family owned businesses.

The researcher argues that, a person being a director of so many companies can never be unbiased or honest with the affairs of any single company. Consequently, the assets of general public and investors are on high stake in such a company. This practice can be diminished by two ways; first, by introducing legislation or making amendment in the CCG and reducing the number of directorship a person can hold; secondly, by making IIs influential via increasing their role in CG which

⁵⁷ Michael Jacobs, 'Combating Anti-Competitive Interlocking: Section 8 of the Clayton Act as a Template for Chile and Similar Emerging Economies' (2013) *Fiscalia Nacional Economica* Working Paper, www.fne.gob.cl/wp-content/uploads/2013/11/Clayton-Act-Section-8.pdf accessed 10th January 2015

⁵⁸ David Schoorman *et al.*, 'Interlocking Directorates: A Strategy for Reducing Environmental Uncertainty' (1981) 6(2) *The Academy of Management Review* 243

⁵⁹ *Ibid*

can be done through giving them proper participation and representation in the BODs that they could monitor the policies and acts of such directors.

Moreover, the new CCG introduced the evaluation criterion of BODs to ensure the accountability of BODs for their policies and actions. However, it is left on the BODs of each company to formulate a framework for its assessment within two years from the issuance of this CCG. The researcher submits that instead of leaving this on each company's BODs, the SECP should devise a general evaluation mechanism for the BODs and put it on its website for the guidance of each company. The companies should evaluate the workings, strategies and effectiveness of their BODs according to those criteria and explain that in their annual reports. However, companies can make changes on those general criteria set by SECP according to the distinct and changed requirements of their business by formally getting permission from SECP on the basis of 'one size not fit all' principle.

Furthermore, the office of the Chairman has been alienated from that of CEO. The Chairman shall now be nominated and selected amongst the NEDs of a listed company.⁶⁰ The directors of listed companies will now be bound to get certification under director training program (DTP) obtainable by any local or foreign institution that fulfils the conditions defined by the SECP.⁶¹ The CCG further asserts that, the BODs will determine the mechanisms for appointment, remuneration and conditions of employment and removal of the Chief Financial Officers (CFO), CS and the Head of Internal Audit (IA) of listed companies instead of CEO.⁶² The Head of IA will not be removed without the consent of the BODs and endorsement of the Chairman of the Audit Committee.

The CCG⁶³ further provides that, there should be a defined and fair mechanism concerning directors' remuneration and its disclosure in the annual report of listed

⁶⁰ Clause (vi) of the CCG 2012

⁶¹ Clauses (xi) of the CCG 2010. The criteria are available at the website of SECP, www.secp.gov.pk accessed 10th June 2014

⁶² Clause (xii) and (xiii) of the CCG 2012

⁶³ Clause (xvii) of the CCG 2012

companies. The chairman of the audit committee will now be an INED, who will not be the chairman of BODs. Audit Committee will consist upon NEDs.⁶⁴ The secretary of Audit Committee will either be the CS or Head of IA and the CFO will not be elected as the secretary to the Audit Committee.⁶⁵ The task of IA might be subcontracted by a listed company to a specialised services company or be executed by the IA staff of the holding company.⁶⁶

The some provisions of the CCG have been reviewed on the basis of lessons learnt from the everyday issues and concerns related to the listed companies. The underlying idea is to ensure that it imitates changing governance apprehensions, economic conditions, practices and international standards. However, the researcher argues that this CCG still has two folds problems. One some of its provisions do not help to solve governance issues rather increase those problems, again for being confusing and overlapping with the Ordinance like the previous CCG 2002;⁶⁷ and secondly, the enforcement problem regarding implementing the CCG in its true sense also remains the same as was with the previous CCG 2002. However, the positive sign as a result of the issuance of CCG is that the people have started to acknowledge CG principles and the importance of good governance.

For example, regardless the voluntary requirement for the appointment of INEDs, numerous companies both listed and non-listed have chosen as INEDs. Though, the individuals ready to serve as INEDs are hard to discover in light of the fact that compensation is not equivalent with their roles and responsibilities. Despite the fact that there are competent applicants, there is minimal impetus for them in such a position without being paid accordingly. A proper remuneration plan is essential to draw in qualified and competent individuals who will to tackle the obligations and responsibilities of this office.⁶⁸

⁶⁴ Clause (xxiv) of the CCG 2012

⁶⁵ Clause (xxx) of the CCG 2012

⁶⁶ Clause (xxxi) of the CCG 2012

⁶⁷ As mentioned in previous paragraphs

⁶⁸ Ibid (n 2) 326; Corporate Governance Country Assessment (Pakistan), June 2005, by World Bank, Report on the Observance of Standards and Codes (ROSC) Corporate Governance; Robert McGee, 'Corporate Governance in Transition and Developing Economies: A Case Study of

Moreover, the new CCG requires from every single listed company to distribute a declaration⁶⁹ along with their annual reports to clarify their position regarding the adoption and compliance with the CCG. The declaration should be certain and anticipated that would be sustained by the vital evidence by the company making such declaration. Every single listed company shall guarantee that the declaration of compliance with the CCG is looked into and affirmed by statutory auditors, where this declaration can be confirmed equitably, before its publication. Statutory auditors should guarantee that any nonfulfillment of the requirements set out by CCG is identified in their annual report. However, in a particular situation in which the compliance with the CCG becomes unworkable, SECP is authorised to grant exemption from the compliance in such situation by properly recording the reasons of non-compliance.⁷⁰

These provisions show that SECP is striving to make the compliance with the CCG better. The researcher submits that, the CCG contains many strong provisions too and as a result the business community has started to give importance to good governance standards. However, there are some basic problems in the CCG which should be considered and removed while formulating the new version of the CCG (which has been discussed above).

In summary, the clauses of CCG should not be in conflict with other corporate laws particularly because the compliance of CCG is mandatory; when the two mandatory laws/rules conflict with each other the implementation of them becomes difficult. The second important thing is the awareness about the advantages to adopt CG principles, the PICG should introduce more effective measures to increase this awareness among business community, as it has been noted that new business men having less or no knowledge and qualification consider CG principles cumbersome and they are scared of these.⁷¹ It can be achieved by organising regular seminars and workshops on the significance of CG

Pakistan', Working Paper, August 2010, Florida International University
<<http://ssrn.com/abstract=1665112>> accessed 10-01-2015

⁶⁹ In the form as specified in Appendix 'B' of the CCG 2012

⁷⁰ Clauses (xI), (xIi) and (xIii) of the CCG 2012

⁷¹ The researcher had a conversation with a CS of a construction company in Pakistan and realised this fact.

principles their impact on maximising shareholder wealth and on companies' performance.

Rating agencies can also play their role in this matter by issuing annual rating list of companies showing the higher compliance with the CCG. The IIs can also play their role in this. In addition to this, CG subject should be included in the curriculum of business schools and it should also be taught to law students at LLB level along with the subject of company law. Thirdly, the misconception about the office of INEDs should also be removed (as identified above too); the people consider this office as honorary that executive directors can appoint any outside director as NED to honour him with directorship.

There should be a proper and stricter mechanism for the appointment, qualification, roles and responsibilities of INEDs. There should also be attractive and defined remuneration package for INEDs as we have seen above it is hard to find INEDs due to no pay. The awareness is required on both sides; the business community and the INEDs regarding the responsibilities of this office that the purpose of appointing INEDs on BODs is to monitor the policies and strategic decision making of BODs to safeguard the interest of shareholders. As the researcher believes that the sole aim of CG is to protect shareholders interest and improve companies' performance.

Lastly, the regulators should revise the CCG every year or at least in every two years considering the environment of corporate sector of Pakistan. As the speed of reform is very slow, the first CCG was issued in 2002, and the second revised CCG issued after ten years in 2012 and now it has been three years the last CCG is not amended and revised. The researcher believes that by amending and revising the CCG regularly considering the needs and changing environment of business community will help in improving the corporate sector of Pakistan to large extent.

4.5 Conclusion

The current chapter has examined the CG framework of Pakistan. It has investigated both CCG issued so far for the corporate sector of Pakistan and has identified their weaknesses. This chapter has also presented recommendations to consider while formulating the next and revised CCG for Pakistan which is one of the objectives of this thesis. The underlying idea was that in order to reform corporate sector of Pakistan and to improve CG practices in the listed companies of Pakistan both 'law in books' and 'law in action' should be effective and efficient. This chapter has analysed the 'law in books' (the CCG) and the next chapter investigates the 'law in action' (the enforcement mechanisms of Pakistan).

CHAPTER FIVE: IMPLEMENTATION AND ENFORCEMENT OF CORPORATE GOVERNANCE PRINCIPLES AND PRACTICES IN PAKISTAN

5.1 Introduction

This study aims to explore measures to improve corporate governance (CG) in the listed companies of Pakistan. For this purpose, the previous chapter has analysed the code of corporate governance (CCG) of Pakistan and suggested recommendations to consider while issuing the new and revised CCG which can improve the CG practices in listed companies.

This chapter relates to the second objective of this thesis and investigates the enforcement mechanisms in Pakistan relating to the implementation of CCG. As in the absence of strong enforcement mechanisms and without implementing the CCG properly, there is no use of updating and issuing CCG. The idea of viable implementation and execution of laws as opposed to just the procurement of law in theory are not new.¹ Academics of corporate law have been debating this matter for a long time. The enforcement of laws is essential in a period of globalisation and competition where cross-border investment has expanded.² This phenomenon identifies the significance of enforcement for local investors as well as to draw in foreign investors.

¹ Roscoe Pound, 'Law in Books and Law in Action' (1910) 44 American Law Review 12

² Luca Enriques, 'Do Corporate Law Judges Matter? Some Evidence from Milan' (2002) 3 European Business Organisation Law Review 812

A legal system becomes strong and works successfully if the framework to control and enforce these laws is also effective and efficient.³ The principle of checks and balances is inevitable for a sound legal system. Weak and overlapping laws and political forces abolish the institutional development of a state. Therefore, a strong and healthy environment is required for the booming of institutions. The appropriate implementation and execution of corporate laws is the obligation of the courts and the capital market.

Therefore, this chapter investigates the issues relating to enforcement of CG generally and investigates specifically the enforcement mechanisms of CG in Pakistan. The current chapter further examines the factors which are responsible for the unsuccessful implementation of CG in Pakistan and recommends measures to improve the enforcement procedures in Pakistan by investigating the role of judiciary and capital market in Pakistan. As the judiciary and capital market are responsible to protect the shareholders' rights and to enforce corporate laws, rules and regulations. This chapter additionally explores the ways to reform judiciary and capital market of Pakistan in order to make them more effective and efficient for the enforcement of corporate laws and the CCG. The following figure shows the plan of this chapter.

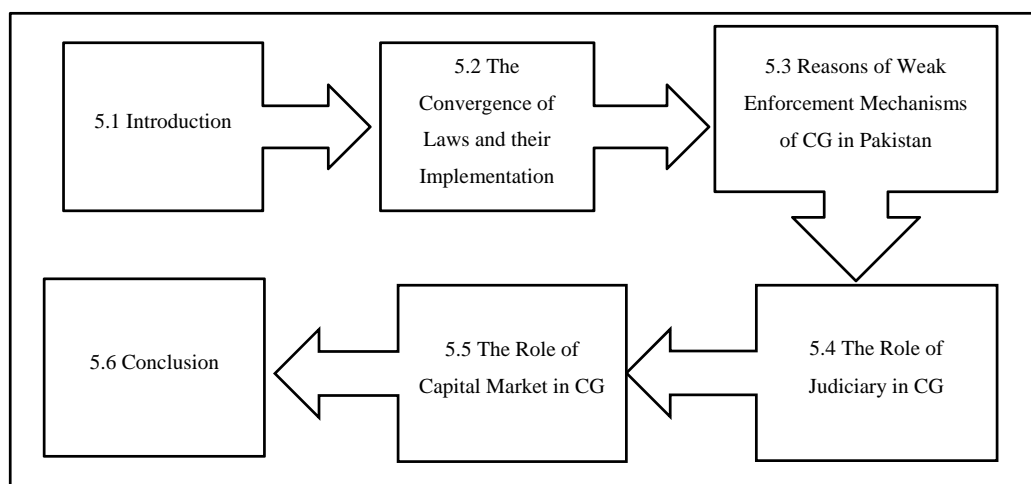


Figure 5.1: Plan of this Chapter

³ Ibid

5.2 The Convergence of Laws and their Implementation

The convergence in CG is becoming the norm in current years in almost every country due to the era of globalisation and competition.⁴ In this process the countries although adapt CG features from foreign countries by necessities however, their feeble implementation system could not enforce those laws and therefore do not create required outcomes.

La Porta, Lopez-ed-Silanes, Shleifer and Vishny (LLSV) have examined in point of interest the safeguard of investors and declared them the principal cause for the growth of business sector and CG principles. They additionally emphasised that the implementation and execution of laws can only be better in the presence of effective laws, especially relating to rights of investors.⁵

Therefore, in the first phase of reform, the 'law in books' is important regardless of the fact that there is lack of strong enforcement system. For example, EU concurrence in eastern and central EU states recommends that the elements of overseas CG can play no less than a positive part on plans of change and their enforcement.⁶ However, the law in action can be guaranteed by upgrading the capability of enforcement institutions in the second stage of reform.⁷ This implies that the countries who adapt CG principles from other jurisdictions should develop their implementation and execution frameworks keeping in mind the end goal to make the transplanted laws more operational and successful.

The procurement of only good laws cannot supplement powerless implementation frameworks; such as, developing jurisdictions transplanted laws from developed economies, yet frail implementation systems permitted the seizure of investors' interests. That is the reason for the powerful arrangement of CG in which rights

⁴ John Coffee, 'The Future as History: The Prospects for Global Convergence in Corporate Governance and its Complications' (1999) North-western University Law Review 641, 642

⁵ LLSV, 'Legal Determinants of External Finance' (1997) 52(3) The Journal of Finance 1131; LLSV, 'Law and Finance' (1998) 106(6) Journal of Political Economy 1113

⁶ Erik Berglof and Stijn Claessens, 'Enforcement and Corporate Governance' (2004) World Bank Policy Research Working Paper 3409, 41
<http://papers.ssrn.com/so13/papers.cfm?abstract_id=625286&download=yes> accessed 10 May 2015

⁷ Robert Cooter, 'Expressive Law and Economics' (1998) 27 Journal of Legal Studies 585, 587

must be ensured and implemented. In short, the amalgamation of both good laws and an appropriate and successful implementation framework supplement one another. Enforcement cannot be fruitful without good laws, and likewise good laws cannot ensure the protection of shareholders in the absences of strong enforcement mechanism.⁸

The issue of implementation is more extreme in transition economies like Pakistan instead of advanced jurisdictions. There have been a few changes during the previous couple of years in Pakistan with the collaboration of International financial institutions (IFI).⁹ The initial step in this respect was the formation of the Securities and Exchange Commission of Pakistan (SECP). The SECP introduced new laws and regulations in order to protect shareholders' interests.¹⁰

Numerous State Owned Enterprises (SOEs) were privatised and the state offered some of its shareholdings to the common business community. This practice motivated additionally FOEs and therefore, FOEs also offered a small portion of their shareholdings to the common public. These changes brought on a blast in the share trading system however, the stock market collided in 2005 resulting into loss of individual and scattered investors by depriving them from their life savings. The regulator could not control and stop this crash and failed to recognise and penalise the offenders.¹¹ The fragile enforcement system of Pakistan frizzled and the incompetent judicial mechanism could not offer a solution to affected persons.

The issue is additionally serious because of the absence of legal ability to uphold the right of shareholders and individual investors. Inefficiency, corruption, nepotism, feudalism judicial expenditures and additional common postponements are the fundamental issues confronting the legal system of Pakistan. The regulator

⁸ Katharina Pistor *et al.*, 'Law and Finance in Transition Economies' (2000) 8(2) *Economics of Transition* 356, 358

⁹ Asim Khawaja and Atif Mian, 'Unchecked Intermediaries: Price Manipulation in an Emerging Stock Market' (2005) 78 *Journal of Financial Economics* 203, 205

¹⁰ Faryal Salman and Kamran Siddiqui, 'Corporate Governance in Pakistan: From the Perspective of Securities and Exchange Commission of Pakistan' (2013) 12(4) *The IUP Journal of Corporate Governance* 13, 14

¹¹ *Ibid* (n 10) 15

additionally is not sufficiently productive to guarantee shareholders' interest. Although SECP is an independent body however, many representatives of SECP are not competent, and need learning about, and ability in, the corporate matters due to their political appointments.¹² Moreover, the other responsible institutions, for example, institutional investors (IIs) are likewise not operating adequately according to the required standards.¹³

5.3 Reasons of Weak Enforcement Mechanisms of Corporate Governance in Pakistan

The primary source for the enforcement of rights in Pakistan is the general courts, which have failed to resolve corporate disputes.¹⁴ In addition to this, the capital market has also neglected to execute laws. A few activities were attempted by the regulator in this manner however they could not deliver ideal outcomes because of the personal stakes of the individuals who did not appreciate and accept even partial change.¹⁵ Along these lines, the researcher argues that it is necessary to upgrade the capability and efficiency of judiciary and to reform the business sector according to the existing business environment of Pakistan. The factors which are responsible for unsuccessful implementation of CG in Pakistan are discussed below.

(a) Non-Serious Role of the Government

The first and foremost factor responsible for the unsuccessful implementation of laws is the non-serious role of government. The government should introduce reforms and take strong legislative measures to build up a suitable and supportive atmosphere for the investors especially IIs so that they could work securely, progressively and actively. But sadly, it is not the priority of the government of

¹² Jaweria Ather, 'Ensuring Capacity, Integrity and Accountability of Regulators and Supervision' (6th Asian Roundtable on Corporate Governance, Organised by OECD, Seoul 2004) <http://www.oecd.org/document/34/0,3746,en_2649_37439_33962850_1_1_1_37439,00.html> accessed 10 May 2015

¹³ Sikander Shah, 'Mergers and the Rights of Minority Shareholders in Pakistan' (2005) Centre for Management and Economics Research (CMER) Working Paper Series No. 04-31, Lahore University of Management Sciences, Lahore Pakistan

¹⁴ Evidence is provided in section 1.2.1.

¹⁵ Families and states owning majority of listed companies of Pakistan using their political powers.

Pakistan (GOP); rather government official break laws and set examples that CG issues are not important. The major corporate and corruption scandals in SOEs discussed in section 1.2.1 are the evidence of *mala fide* on the part of government.

The second sad factor is that due to political instability in Pakistan governments do not focus on the updating of laws and on their enforcement mechanisms; rather focus on completing their tenure, coming into power again and make only short-term decisions for their personal benefits.

For example, instead of providing health facilities in government hospitals (where dozens of patients die every year due to the non-availability of required machinery including oxygen masks, monitors etc.), and in schools (where children do not have desks to sit, books to read, water to drink, fans in summer, and qualified teachers to teach them) which are the basic needs; the current government is investing billions of rupees on show case projects like Metro bus, Orange line train just in some kilometres of one city, distributing laptops among some students; and many more such type of waste projects. High rate of corruption and the absence of effective system of check and balance are also the contributing factors in this regard.¹⁶

The government's preference is not to upgrade and enhance the skills, experience and qualification of directors of SOEs; instead the political alliance of individuals is key for selection on the BODs, and this is one of the serious considerations for the failed enforcement of CCG in its true form. Numerous SOEs are working as both listed and non-listed companies. These SOEs are controlled politically and each government retains control of these companies subsequent to coming into power,¹⁷ for example, the Nandi-Pur Power Project (NPP) as examined in section 1.2.1.

The executives and directors of the BODs stay in such positions at the delight of

¹⁶ The researcher's own observation.

¹⁷ Ibid (n 10) 15

the new government.¹⁸ Such practices should be discouraged as these do not let CG practices to develop. Laws should be manufactured in a way that directors and management could not be changed and appointed at the pleasure of anyone. Financial press and rating agencies can play their part in this regard by highlighting such companies and by lowering their ratings. In addition to them, IIs can also play their role in diminishing such mal-practices.

(b) Family-Owned Enterprises (FOEs)

The second contributing factor for the non-adoption and implementation of CCG is that the corporate sector of Pakistan is vastly concentrated with FOEs. The leading companies in Pakistan including automotive, textile, agriculture sector and tobacco have been controlled by families through generations via cross shareholdings and pyramid structures.¹⁹ However, this family controlled trend has started to be changed due to the entrance of educated people graduated from best foreign universities who comprehend the serious negligence of not adopting CG principles and the awareness among big corporations.²⁰

The role of multinational companies cannot be denied in this regard. Multinational companies follow CG best practice principles, their standards, reputation, working strategies and increasing financial outcomes attract local companies too. Resultantly, a healthy trend of changing the family dominance among corporations is shifting.

The basic scruple in majority of FOEs is a fear that relinquishing control and making the board of directors (BODs) diverse would not be favourable for their interests. To transform this misconception, proper education should be given to

¹⁸ Imtiaz Khan, 'The Role of International Organisations in promoting Corporate Governance in Developing Countries – A Case Study of Pakistan' (2012) *International Company and Commercial Law Review* 2, 6

¹⁹ Waqar Ghani and Junaid Ashraf, 'Corporate Governance, Business Group Affiliation and Firm Performance: descriptive Evidence from Pakistan' (2005) Centre for Management and Economic Research Working Paper Series 05-35, Lahore University of Management Sciences, 19

²⁰ Ibid

the owners, directors, officials and all stakeholders on the advantages of diversified BODs²¹ (this issue is investigated in this thesis in chapter six).

(c) The Lack of Focus on Equity Culture

The reduced concentration on the equity culture and less active stock market is also an important cause responsible for the non-adoption and weak enforcement of CG principles in Pakistan.²² The growth of equity culture in Pakistan was dispirited badly due to extraordinary return on government bonds in the early eighties and relaxed admittance to bank loans in the nineties. This practice of debt financing (bank loans) is still prevailing which is a colossal hurdle in the growth of equity culture and resultantly, equity market has to lean towards big companies. The big family companies are usually contented with and wants to retain their position in business sector and unluckily do not let their control to be weakened by offering shares to general public.²³

(d) Inactive Financial Press (FP)

Inactive FP is another important element responsible for the unsuccessful implementation of CCG in Pakistan. The Pakistani FP does not highlight and discourage the non-compliance, and neglects to give the extra level of implementation required for good CG. The FP generally assumes a critical part in advancing CG principles, particularly where conventional enforcement mechanisms are missing and inadequate.

²¹ Awais Gulzar and Zongjun Wang, 'Corporate Governance and Non-Listed Family Owned Businesses: An Evidence from Pakistan', (2012) 1(2) International Journal of Innovation, Management and Technology 124, 128; The Corporate Governance Guide, *Family-Owned Companies* (Pakistan Institute of Corporate Governance, The Institute of Chartered Accountants of Pakistan, Centre for International Private Enterprise, 2008); Arshad Hasan, 'Impact of Ownership Structure and Corporate Governance on Capital Structure of Pakistani Listed Companies' (2009) 4(2) International Journal of Business Management 2

²² Ibid

²³ Zulfiqar Ali and Safdar Butt, 'The Impact of Corporate Governance on the Cost of Equity: Empirical Evidence from Pakistan Listed Companies' (2009) The Lahore Journal of Economics 139 <<http://www.ssrn.com/abstract=1732509>> accessed on 10 May 2015; Jawad Iqbal and Salman Shehzad, 'Relationship of Cost of Governance and Firm's Profitability' (2010) 16,17 <<http://ssrn.com/abstract=1530726>> accessed 10 May 2015

Therefore, a dynamic FP that stays with shareholders side by side for improvements is basic to individual investor security. The view of business class of Pakistan is that the FP of Pakistan is yet emerging and is not as dynamic as it ought to be. No less than two daily English papers are generally streamed in the market. While main local and foreign corporate growths are extensively covered in these papers, however a typical objection is the viability of the Pakistani FP in affectively seeking after corporate issues.²⁴

The television is preferred to dynamic prevention as compared to the FP. Numerous financial news stations have showed up in Pakistan in the previous couple of years. The latest participant is CNBC Pakistan. These systems can play a noteworthy role in improving compliance with the CCG by highlighting the companies not following CCG and by providing information on the markets.²⁵

(e) Problems With the Implementation of CCG

The researcher highlights that the problems with the implementation of CCG in Pakistan are two fold, as the provisions of the CCG are in two different forms, some are voluntary in nature and some are mandatory (see section 4.4). In short, Pakistan's CCG is a combination of soft law and hard law. Therefore, the solution to these issues should also be in two different ways.

The researcher further highlights that in this situation another question can be raised that why the CCG in Pakistan is mixed with hard law and soft law; should it be only in the form of soft regulations as in the most other countries; or should it completely be in the form of hard law.

The answer is that the existing form of the CCG of Pakistan is completely suitable in Pakistan's corporate sector according to its culture. The argument is; a complete hard law is already present in the form of Companies Ordinance 1984, therefore no need of another hard law. The other argument is that the CCG are

²⁴ Haroon Hamid and Valeria Kozhich, 'Corporate Governance in an Emerging Market: A Perspective on Pakistan' (2006) 1(1) Journal of Legal Technology Risk Management 1 <<http://www.ssrn.com/abstract=976499>> accessed 10 May 2015

²⁵ Ibid

considered to be for the guidance of the companies for better CG and they are mostly in the form of soft law as in the UK, and some other countries. However, a complete soft law cannot work effectively in Pakistan. The reason is the lack of awareness among shareholders, stakeholders and the general community of the potential benefits observing the CCG.

Moreover, the similar example of the combination of hard law and soft law is already prevalent in South Africa in the form of 'apply or explain' approach. The King III code of South Africa, as with King I and King II, is also built on this principle. According to this, it is necessary for directors to 'apply' their code or 'explain' the reasons if they do not do so. The underlying idea is that this language expresses the intent of the King code more appropriately from inauguration. However, the problem with the Pakistan's CCG, is that there is no such provision which could clarify how to comply with the provisions and to which extent those provisions are mandatory.²⁶

Therefore, the researcher contends that, the first step, in order to make the CCG effective in Pakistan's corporate sector, there should be some mandatory provisions as they are, so that those provisions could be implemented forcefully and other provisions to be left voluntary and regulators should take such measures to enforce them. These two aspects are discussed below.

The implementation of CCG is a main issue.²⁷ The CCG of Pakistan has a number of provisions which require binding obligation (see section 4.4), which encounter the control of families and the state. Consequently, those families and state are hesitant to adopt the CCG completely. The compliance with the CCG is a condition for companies to be listed on stock exchange but this condition is not being fulfilled as a component of listing regulations.

²⁶ Institute of Directors Southern Africa, 'King Code of Governance for South Africa 2009' <http://www.ngopulse.org/sites/default/files/king_code_of_governance_for_sa_2009_updated_june_2012.pdf> accessed 20 June 2015

²⁷ Ruth Aguilera and Alvaro Ceurvo-Cazurra, 'Codes of Corporate Governance Worldwide: What is the Trigger?' (2004) 25(3) Organisation Studies 417

The researcher finds no proof of any move being made by authorities for non-adoption and non-implementation of CCG. The yearly reports of significant number of companies demonstrate that these reports only cover and contain generalised information about the company. The researcher observes that there is an absence of comprehension of the potential advantages attached to adopt and implement the CCG. There is only box ticking as opposed to substantial adoption of the CCG in its actual form.

The review of annual reports of many listed companies confirms that a large portion of public listed companies are either family-owned or state-owned which do not let the CCG to be implemented appropriately. This view is also endorsed by the director of SECP.²⁸ The directors of BODs consist upon either relatives in case of family-owned companies and individuals having political affiliations in case of SOEs.

Similarly any relative is usually appointed as INED. For this purpose, some shares are issued in the name of major children and declare them as INEDs just to satisfy the condition of CCG by claiming those kids independent.²⁹ The researcher asserts that the reason of this may also be an assumption in the business community of Pakistan that they consider the office of independent director just an honorary position and do not realise that, the actual purpose of this office is to monitor the policies and strategic decision-making of BODs.

The researcher further submits that there must be some mechanism which could evaluate the accuracy of disclosure made by companies in their annual statements and impose fine on the non-compliance of mandatory provisions of the CCG as well as for providing the false statement in annual report. External auditors can be appointed for this purpose.

²⁸Rasul Rais and Asif Saeed, 'Regulatory Impact Assessment of SECP's Corporate Governance Code in Pakistan' Lahore University of Management Sciences (LUMS) Paper Series, CMER Working Paper No. 05-39 (2005) 13; Mahwesh Mumtaz, 'Corporate Governance in Pakistan- Adopt or Adapt? Paper presented at a conference in Lahore on 3-4 June 2005 organised by the SECP and Lahore University of Management Sciences

²⁹ Ibid (n 10) 15; For example the textile companies of Pakistan such as, Al-Karam Group of Companies, Chenab Group, Nagina Group and many more.

The CCG 2012 in its clauses (xI), (xIi) and (xIii) provides the procedure to comply with the CCG and disclose it in yearly reports according the form specified in Appendix B of the CCG. However, the CCG does not provide that if a company does not follow this procedure and commits non-compliance then what action can be taken against that company. The only thing comes in researcher's mind is delisting, as SECP has included the compliance with CCG as listing requirements. But this act of delisting is very harsh particularly for a stock market which has only a few large companies listed on it.

Therefore, the researcher contends that the introduction of pecuniary penalties may fulfil this purpose. Secondly, in these circumstances the influence of investors particularly IIs might be the most prompt reaction to resistance to adopt CCG, through which they can exert pressure significantly on their investee companies due to their large shareholdings and can look for confirmation from the administration to adopt and implement CCG in their investee companies. Moreover, rating agencies and media can also play a significant role in pressurising non-complying companies which will also create a healthy environment of competition.

Furthermore, another serious issue related to the implementation of CCG is the penalty structure. As mentioned in previous sections, the compliance of CCG is part of listing regulations (LR) and therefore, non-compliance with CCG considered as the infringement of LR and the only punishment in case of violation of LR is delisting, which is not appropriate and very strict specially in case of partial compliance. As LR neither clarifies the difference between the full and partial violation of CCG nor provide separate mechanisms to tackle these situations.

The regulator is additionally not willing to enforce this penalty in the form of delisting due to some reasons.³⁰ Firstly, the number of listed companies is already very less and delisting will further reduce this number. Secondly, delisting damages the shareholders who are usually not responsible for such violation.

³⁰ Ibid (n 10) 17

Therefore, the penalty mechanism should be revised and alternative penalties should be introduced instead of delisting such as, in the form of fine in order to make enforcement effective and appropriate.

However, the penalty should be commensurate with the quantum of non-compliance. It could be measured in two ways: one according to the capital (wealth) of a company and secondly, the loss which occurs particularly to shareholders as a result of non-adoption of CCG. The scholars of corporate law also believe that the absence of penal provisions in the CCG of Pakistan limit their enforcement.³¹ The argument is that instead of de-listing, the inclusion of penal provisions in CCG may make it more effective in developing good CG in Pakistan. A more dynamic controlling mechanism, balanced between unnecessary intrusion and no monitoring, may guarantee better defiance with the CCG.

5.4 The Role of Judiciary in Corporate Governance

Companies take decisions on the basis of majority vote.³² However, there is possibility that a few individuals might gain advantage through illicit ways or by utilising their overwhelming influence at the expense of minority votes. Such activities might be legitimate and inside their mandates and their directives however the result of these acts might be the seizure of the interests of minority and individual shareholders, which is unlawful.

For example, utilising voting powers to settle on choices whose goal is to crush out or weaken minority shareholders' voting right. Besides, utilising their predominant position to elect directors or different administrators whose aim is to give benefits to relatives and friends. In addition to this, making contracts with different companies or privately owned businesses in which the interests of shareholders having large shareholdings are involved.

³¹ The World Bank, 'Report on the Observation of Standards and Codes (ROSC) Corporate Governance' (2005) Corporate Governance Country Assessment of Pakistan 4

³² For example the BODs finalise a decision if majority of directors vote in favour.

Therefore, the issue of differentiating between lawful acts and lawful ways to accomplish illegal acts is constantly left to the courts to decide. This interpretational role³³ of the court highlights the significance of judiciary; and the incompetence of the legislature to anticipate likely future problems maximises this judicial role.³⁴ This role highlights the influential role of the courts and secondly, the decisions of courts directly affect future decisions, as they become point of reference called precedent and these precedents are mandatory to be considered by inferior courts, and influential for equal and foreign courts for future decisions.³⁵

The native courts in common law countries like Pakistan might get assistance by the decisions of even overseas courts.³⁶ However, the capability of judges to interpret those choices and relate them to their particular situations might be challenging for an inefficient and inactive judicial mechanism.³⁷ The issue could be even more serious in case of specialised matters such as corporate matters.

The judges in the courts in Pakistan do not generally have appropriate knowledge and skills to deal with corporate and other business issues.³⁸ They keep case law unclear and ambiguous purposefully as they do not have expertise to deal with analytical as well as legal perceptive.³⁹ The researcher submits that weak and inefficient legal framework in Pakistan is one of the basic issues concerning to implementation and enforcement, which is one of the major, cause of a weak CG system, and an obstacle in pulling foreign as well as domestic investment.

³³ This interpretational role of courts is discussed below (section 5.4.2).

³⁴ Jonathan Macey, 'Courts and Corporations: A Comment on Coffee' (1989) 89 Columbia Law Review 1698, 1700

³⁵ Faqir Hussain, 'The Judicial System of Pakistan' (2011)

<http://www.supremecourt.gov.pk/web/user_files/File/thejudicialsystemofPakistan.pdf> accessed 20 June 2015

³⁶ Ibid

³⁷ Inefficiency of Pakistan's judicial mechanism is discussed below.

³⁸ The World Bank (ibid 31)

³⁹ Living Armytage, 'Pakistan's Law and Justice Sector Reform Experience-Some Lessons' (2003) Centre for Judicial Studies, 13th Commonwealth Law Conference in Melbourne

<<http://www.educatingjudges.com/Hyperlinks/PakistanADBProjectLessonsLearned.pdf>> accessed 15th October 2015

5.4.1 Corporate Judicature in Pakistan

The judicial framework of Pakistan experienced and went through three different phases of historical growth, to be specific, Hindu Kingdom, Muslim Rule and British Colonial organisation. The fourth and current phase is a result of independence of Pakistan as an independent and Free State. Therefore, the framework has grown through a series of change and improvement. The historians and critics of Indian history are unanimous on this.⁴⁰ During this process of development, the judicial framework of Pakistan has been influenced by both foreign and local doctrines and norms. As a result, the organisation, structure, hierarchy and the procedures to take decisions in judiciary of Pakistan are inspired and influenced by those foreign and local practices.⁴¹

Hence, the present legal framework of Pakistan is not completely derived from foreign countries as normally considered; it has also obtained native norms' flavour. Furthermore, although the framework is not completely appropriate for the necessities of our kin or fulfil the indigenous conditions, its constant adoption and practice has made it coherent to people. It is asserted that the reality of expanding number of individuals making resort to courts for resolving their disputes shows the acceptance and legitimacy of the system.⁴²

However, the researcher argues that, this is not the criteria by which the efficiency and effectiveness of a system could be judged, i.e. that a large number of people are going to courts taking their grievances when there is no alternative forum available to them. In reality, the judicial framework of Pakistan has been unsuccessful in delivering justice.⁴³

⁴⁰ Osama Siddique, 'Approaches to Legal and Judicial Reform in Pakistan: Post-Colonial Inertia and the Paucity of Imagination in Times of Turmoil and Change' (2011) Development Policy Research Centre (DPRC) Working Paper 4, LUMS Lahore 14
<http://dprc.lums.edu.pk/components/com_publications/attachments/DPRC-WP4-Siddique.pdf>
accessed 10 June 2015

⁴¹ Ibid

⁴² Ibid (n 40)

⁴³ The evidence and examples of this fact are provided in section 5.4.2

The Constitution of Pakistan⁴⁴ cherished the latest version of the judicial structure of Pakistan.⁴⁵ The corporate judicature is set out according to the Companies Ordinance 1984, the SECP Act, 1997 and the Constitution of Pakistan. The persons having grievances relating to corporate matters can file a complaint or a petition in two mediums: the SECP and general courts.

The appropriate medium for filing a complaint regarding corporate matters is the SECP, and can hear complaints in two conditions: when the SECP is declared as the appropriate medium for filing a complaint and; when the provisions of the Ordinance⁴⁶ are violated and no forum is declared to initiate a complaint and the punishment for the infringement is just fine. The second medium is general courts in two conditions: when the court is stated as an appropriate medium and; when the punishment for infringement is imprisonment with or without a fine.⁴⁷

The Ordinance states that in situations where the punishment is a just fine, the officials of the SECP retain the authority to entertain these cases relying on the amount of fine.⁴⁸ A revision application against the decisions of assistant registrar, deputy registrar, joint registrar and additional registrar can be filed to the Registrar of Companies.⁴⁹

Likewise, a revision application against the decision of a registrar and any other official authorised by the SECP can be filed with the commission.⁵⁰ The commission retains the authority to revise any decision of any officer of the SECP, and the decision of the commission will be ultimate and absolute.⁵¹ Likewise, the commission and registrar retain the authority to review their own

⁴⁴ The Constitution of Islamic Republic of Pakistan, 1973

⁴⁵ Part VII, Articles 175-212, the Constitution of the Islamic Republic of Pakistan 1973

⁴⁶ The Companies Ordinance 1984

⁴⁷ S. 476 of the Companies Ordinance 1984 (the Ordinance)

⁴⁸ Part II of the Ordinance.

⁴⁹ S. 477 (1) (a) of the Ordinance

⁵⁰ S. 477 (1) (b) of the Ordinance; Commission means the Securities and Exchange Commission of Pakistan

⁵¹ S. 484 (1) of the Ordinance

decision and that order will be final.⁵² An aggrieved person can also file an appeal to the High Court (HC) in spite of review, revision or appeal by the SECP.⁵³

The SECP may inaugurate Appellate Benches authorised to entertain an appeal within the SECP.⁵⁴ If the decision is taken by the commission consisting upon one commissioner, in that case the right of appeal is to the Appellate Bench consisting upon commissioners (more than one), and this Bench will not include those commissioner who had made the original decision. An appeal against an order of the Appellate Bench will be to the courts according to the Part II of the Ordinance within 60 days.⁵⁵

The following figure shows the structure in case of different penalties for aggrieved parties that where to lodge a complaint.

⁵² S. 484 (2) of the Ordinance

⁵³ S. 485 (1) of the Ordinance

⁵⁴ S. 33(2) of the Securities and Exchange Commission of Pakistan Act 1997 (the SECP Act, 1997)

⁵⁵ Ss. 33-4 of the SECP Act, 1997

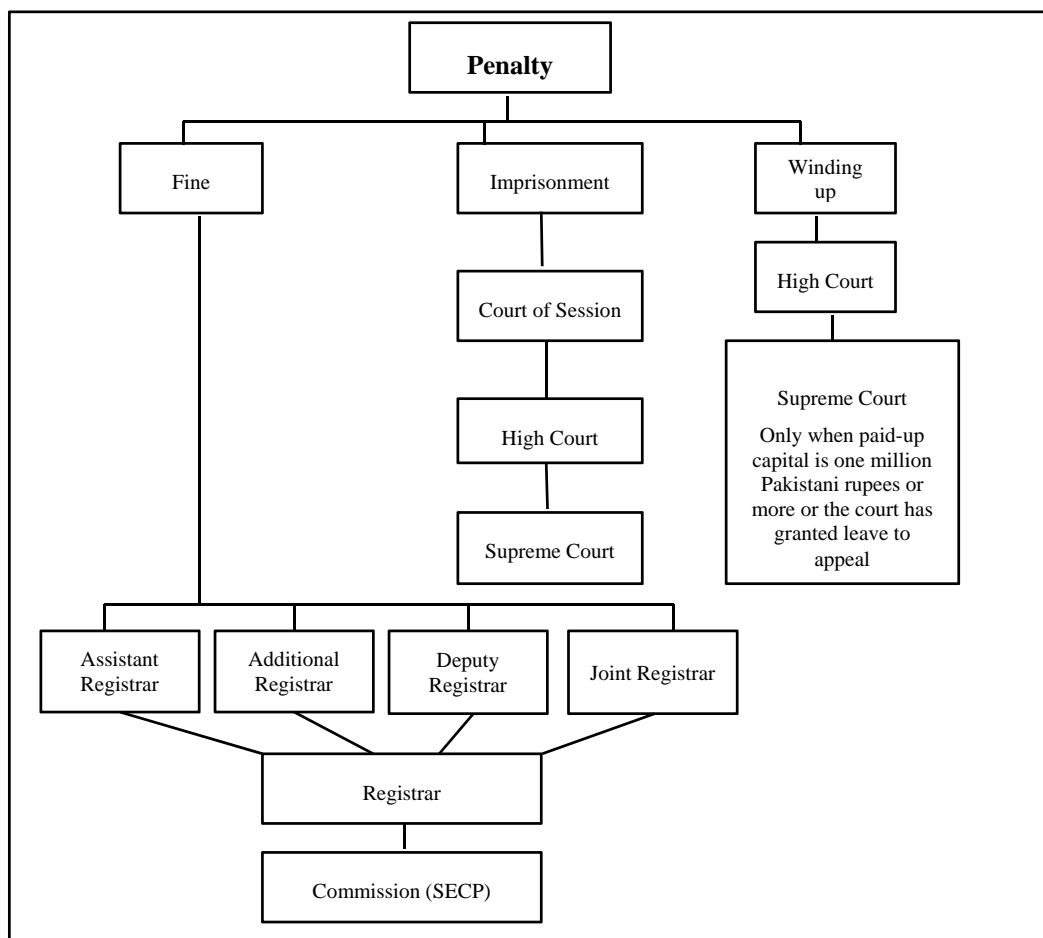


Figure 5.2: Pakistan's Penalty Structure in Relation to Corporate Matters⁵⁶

The Ordinance outlines the judicature of corporate matters.⁵⁷ It confers authorities to the HC in corporate matters. The Chief Justice (CJ) of the relevant HC has power to give direction to company benches to deal with corporate cases. The central government might additionally authorise any civil court to deal with the cases comes under its jurisdiction. The appeal structure is similar for corporate cases as for general matters.

The appeals against the decisions of civil and criminal courts will go to a district court and session court correspondingly. An appeal against the order of the district court or the session court will go to the HC, and against the decision of the HC to

⁵⁶ Developed by the researcher according to the Companies Ordinance 1984

⁵⁷ Sections 7-10 of the Companies Ordinance 1984

the Supreme Court (SC). Though, an appeal relating to the issues of winding-up is restricted to the SC.⁵⁸

Moreover, the Ordinance states that the cases that come under the Ordinance will be dispensed with by the courts under summary proceeding and will be decided within 90 days. The cases will not be adjourned for more than 14 days at a time or more than 30 days as a whole, but for adequate reason.⁵⁹ The intention of Ordinance is to discard corporate cases speedily however; the courts do not take after these procurements in practice. Courts do not consider the binding form of the law and view it as being of just guiding principles.

This demonstrates the non-serious approach of the courts in regards to dispose of corporate matters speedily. Another cause behind why cases are not managed rapidly might be the load on the courts which makes it difficult for them to dispose of these matters inside the time span fixed by the Ordinance. The researcher submits that, this may be the case everywhere, but it is necessary to resolve this issue by increasing the number of judges so that the cases could be disposed of quickly, as due to this undue delay aggrieved parties have to suffer a lot in terms of time, money and also psychologically and emotionally.

The following figure shows the structure of corporate Judicature in Pakistan.

⁵⁸ Ss. 7-10 of the Ordinance

⁵⁹ S. 9 of the Ordinance

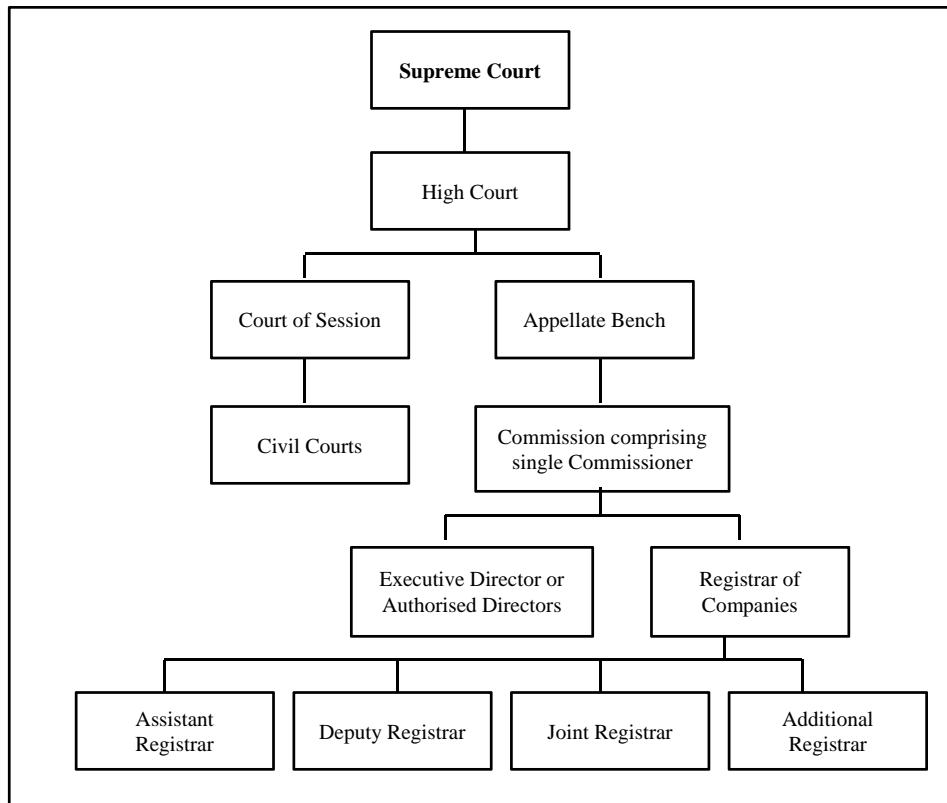


Figure 5.3: The Structure of Corporate Judicature in Pakistan⁶⁰

5.4.2 The Judicial Problems in Pakistan

The leaders of the nation have truly traded off the autonomy and uprightness of the courts for various reasons. Pakistan obtained independence in 1947 yet, ruled by dictators for many years,⁶¹ and these dictators attempted to control the judiciary so as to grow their tyrannical administration. They made Provisional Constitutional Orders (PCOs) for the purpose of controlling the judges of superior courts. These acts prompted the devastation of judiciary as an institution.

⁶⁰ Adapted from Imtiaz Khan and developed according to the provisions of the Companies Ordinance 1984

⁶¹ First Martial law was from October 1958 to March 1969; the second was from March 1969 to December 1971; third was from July 1977 to August 1988; and the fourth was from October 1999 to August 2008. This period consists upon more than 33 years out of 68 years of independence of Pakistan till to-date December 2015.

In addition to this, the judiciary could not be separated from the Executive in spite of the provisions of the Constitution 1973.⁶² The political influence on the judiciary is another major cause which is not letting the Judiciary of Pakistan to be established as a strong and independent institution. For instance, the Constitution of Pakistan provides comprehensive guidance relating to the composition, jurisdiction, powers and functions of the courts. The Constitution requires the separation of judiciary from the executive and its autonomy.⁶³ It confers the responsibility to protect, preserve and protect the Constitution on superior courts.⁶⁴ The Constitution also provides the procedures for the appointment, qualification and remuneration of judges.⁶⁵

The Constitution further elaborates that the remuneration of judges and different managerial expenses of the apex courts will be paid by the Federal/Provincial Consolidated Fund.⁶⁶ It means that the issue of judges' remuneration and other expenditures of apex courts can be discussed in the legislature but cannot be voted upon. Furthermore, the Constitution additionally offers the mechanism for the dismissal of the superior courts' judges.⁶⁷

According to this mechanism, the Supreme Judicial Council (SJC), comprising of the senior judges of the SC and HC, on a reference made by the President or on its own, can remove a Judge due to misbehaviour, delinquency or physical or mental incapacity. Therefore, the independence of the apex judiciary is essential and the provisions of the Constitutions ensure this independence and impartiality of the apex courts.

However, the SC and HCs have been given financial autonomy recently; as a result of a ruling given by the SC in the case of *Government of Sind v Sharaf Faridi*.⁶⁸ The Court said that the independence of judiciary and its separation from

⁶² Article 174 clause (3) of the Constitution

⁶³ Preamble and Article 2A of the Constitution

⁶⁴ Article 178 and 194 read with the 3rd Schedule

⁶⁵ Article 177, 193 and 205 read with Schedule 5.

⁶⁶ Article 18 to 21

⁶⁷ Article 209 of the Constitution

⁶⁸ *Government of Sindh v Sharaf Faridi* PLD 1994 SC 105

the Executive requires exclusion of Executive control on financial matters of the judiciary. Therefore the CJ of the SC and the HC should have authority to re-assign the funds in the allocation of budget without the endorsement of Ministry of Finance (MOF). In addition to this, the CJ should be authorised to re-assign funds from one head to another and also to generate/abolish posts in the judiciary as well as to upgrade and downgrade those posts.

The SC gave this ruling while interpreting Article 175(3) of the Constitution, according to which the judiciary should be separated from the Executive gradually within 14 years of the commencement of the Constitution. The Court ruled that in the light of this provision of the Constitution, the roles and responsibilities of magistracy should be alienated and the judicial magistrates must be positioned under the administrative control of the HC. The Court gave the deadline of 23rd of March 1994 to carry out this order. However, this date was extended to 23rd March 1996 as a result of a review petition before the SC. Consequently, amendments were made in law and the judicial magistrates positioned under the administration of HC.

Later, in the cases of *Al-Jehad Trust v Federation*⁶⁹ and *Asad Ali v Federation*⁷⁰ the SC further interpreted numerous provisions of the Constitution and elucidated the mechanisms and qualifications for appointment of the SC, HC and the CJs of the respective courts.⁷¹

Prior to these amendments, the CJ of Pakistan was used to select a board for the judges of the SC and recommend that board to the President and the President was to choose an appropriate judge from that board. Likewise, to appoint judges of the HC, the concerned CJ of that HC used to select a panel and forward that to the President through the Governor of the Province and CJ of Pakistan. The reference

⁶⁹ *Al-Jehad Trust v Federation* PLD 1996 SC 324

⁷⁰ *Asad Ali v Federation* PLD 1998 SC 33

⁷¹ The Constitution 19th (Amendment) Acts 2010

of the CJ was obligatory on the President to follow, otherwise the President used to record strong reasons for not accepting the recommendation of the CJ.⁷²

This mechanism has now been changed through the 19th Constitution (19th Amendment) Act 2010, the intention of which is to strengthen the parliamentary system instead to strengthen the judiciary and improve the relations between federation and provinces. The Parliament approved two forums for the selection of judges of superior courts including, SC, Federal Shariat Court (FSC) and HC.

One, Judicial Commission (JC), supervised by the CJ of Pakistan and consisting upon senior judges of the SC, CJ and senior judges of HC and Attorney General (AG) of Pakistan, Federal and Provincial Law Ministers and the agents of the Federal and Provincial Bar Councils. The JC proposes names for every post. This proposal is sent to the Parliamentary Committee (PC) for ratification. The PC consists upon eight members, four from National Assembly and four from Senate. The names ratified by PC are sent to the President, through the Prime Minister (PM) for appointment.⁷³

This amendment was challenged in the SC and inspected by a seventeen-member bench, which decided unanimously to forward a reference to the PC with definite proposals to develop the procedure of appointment of judges. The Parliament cordially accepted the reference and approved several proposals through embracing the Constitution (19th Amendment) Act, 2010.

According to the 19th amendments, judges of the SC are appointed through the JC comprising upon the CJ of Pakistan as Chairman, four senior most judges of the SC, one former CJ or judge of the SC, selected by the Chairman with the consultation of four member judges for a period of two years, the AG of Pakistan, the Federal Law Minister and a senior advocate of the SC, nominated by the Pakistan Bar Council (PBC).⁷⁴

⁷² Chapter 1, Article 175A; Chapter 2, Articles 177; Chapter 3, Article 193

⁷³ Article 175A of the Constitution after 19th amendment.

⁷⁴ Article 175A Clause (2) of the Constitution.

After the approval of a name for the judge of the SC by JC, it is forwarded to PC comprising upon eight members having equal representation of government and opposition and both houses of the Parliament. The PC if approves the name within two weeks, that name is sent to the President through the PM. However, the PC retains the authority to disapprove the name recommended by JC by 3/4th majority, and in that case the decision of PC is forwarded to the JC via PM and then JC forwards another name for appointment.⁷⁵

However, a mechanism of accountability is inevitable for the judicial autonomy. The Constitution provides this mechanism in the form of Supreme Judicial Council (SJC). The SJC consists upon the CJ of Pakistan as Chairman, two most senior Judges of the SC and two most senior CJs of HCs. The Registrar of the SC acts as the Secretary of the SJC. On the reference from President or via *suo moto* action, the SJC examines the matter and forwards its judgement to the President. If the SJC decides that the respective Judge is not able to accomplish his duties or is guilty of misconduct, and hence should be fired, the President can order the dismissal of that respective judge.⁷⁶

The researcher believes that there was no need for this amendment (19th) in the Constitution; this amendment is done only to control the judiciary and establish the authority of Parliament over Judiciary which is also the dominance of Executives over Judiciary.

There are a number of corruption cases involving top ministers, politicians and even on current and former PMs, but we have not seen the judiciary taking action against them. While, the CJ of Pakistan takes *suo moto* action on petty matters, he does not take any action on big corruption cases. This is the case only of superior judiciary in Pakistan which is even much better than the lower courts. The state of lower courts is even worse and how can we expect justice, independence and impartiality from the lower courts of a judicial system where superior courts are not independent and cannot do justice.

⁷⁵ Article 175 A of the Constitution

⁷⁶ Article 209 of the Constitution

Furthermore, inefficiency of the judiciary is another problem.⁷⁷ The judicial procedure is complicated, which causes delays in deciding cases. In addition to this, the incompetence of judges to handle technical cases, less number of judges, lack of facilities and support staff also cause inordinate and unreasonable delays.⁷⁸

Some steps were taken by the foreign institutions to reform the judiciary in Pakistan, but due to the *mala fide* of rulers those steps could not succeed. The first step was taken by the Asian Development Bank (ADB) in 2001 under the 'Access to Justice Program',⁷⁹ the aim of which was increasing the number of judges in the courts.

The second step was taken by the United States Agency for International Development (USAID) in 2009 with the aim of '*Strengthening Justice with Pakistan*' which included US\$90 million.⁸⁰ The aim of this initiative was to maximise judicial competence, transparency, accessibility, independence, accountability, efficacy, protection of private businesses and foreign investment.⁸¹

These initiatives could not be successful because of the lack of consensus regarding the terms and conditions of the applicability of these steps between the GOP and USAID. The failure of international organisations and the GOP to improve the judicial structure of Pakistan is additionally a key factor which did not let the judiciary to be and perform as a strong and independent institution.

Moreover, the absence of enforcement power with respect to judiciary in Pakistan is one of the primary causes of corruption in every public and private sector of country. This absence of enforcement power influences each segment of country, including corporate sector. The shareholders' rights, particularly the minority and individual shareholders' rights, are more terrible in a powerless legal framework,

⁷⁷ Ibid (n 40)

⁷⁸ Ibid (n 40)

⁷⁹ ADB Completion Report, 'Pakistan Access to Justice Programme' (2009) 1
<<http://www.adb.org/sites/default/files/projdocs/2009/32023-01-pak-pcr-pdf>> accessed 10 June 2015

⁸⁰ USAID Program, 'Strengthening Justice with Pakistan' (2009) 9
<http://www.fbo.gov/index?s=opportunity&mode=form&id=1a353d985a6979255fe8491f0d59c8b2&tab=core&_cview=1> accessed 10-01-2015

⁸¹ Ibid

and the frail enforcement framework influences the entire economy of the state. Therefore, judicial reform is inevitable to make the laws enforceable, as without implementation and enforcement there is no use of any law.

5.4.3 Reforms in the Judicial System of Pakistan

The safeguard to shareholders' interests can be ensured by the courts, government organisations and other market contributors,⁸² and to attract foreign investments, foreign investors need protection against expropriation of their assets.

The judiciary is regarded as the primary forum in securing the rights of investors. One view in this regard is that the burdens on judiciary could be reduced if other institutions are strong enough to ensure investor protection. Nevertheless, regardless of the fact that other supporting institutions are made strong, the significance of the judiciary stays at its place. The interpretation of law and other legal matters require judicial involvement. Hence, improving the system but disregarding the weaknesses in the judiciary might not create ideal results.

Nonetheless, improving the judicial system is a challenging and lengthy procedure which requires the support of politicians and other groups having vested interests.⁸³ Political and financial restrictions can influence these endeavours,⁸⁴ because of the reason that the interests of large business groups and the politicians are associated.⁸⁵

Another hurdle in this step could be those families who hold and control a number of companies are politically powerful as well.⁸⁶ They confiscate minority and individual investors as well as the companies.⁸⁷ Consequently, they do not welcome reforms whose purpose is to expand shareholders security by improving

⁸² LLSV, 'Investor Protection and Corporate Governance' (2000) 28 *The Journal of Finance* 24

⁸³ Leora Klapper and Inessa Love, 'Corporate Governance, Investor Protection, and Firm Performance in Emerging Markets' (2004) 10 *Journal of Corporate Finance* 723

⁸⁴ Erik Berglof and Stijn Claessens, 'Enforcement and Corporate Governance' (2004) World Bank Policy Research Working Paper 3409, 37

<http://papers.ssrn.com/so13/papers.cfm?abstract_id=625286&download=yes> accessed 15th October 2014

⁸⁵ See section 1.2.1

⁸⁶ Discussed in section 5.3, 4.3 and 1.2.1

⁸⁷ Ibid

enforcement frameworks; as the reformed judicial system can reduce their control of expropriation; hence, they do not favour reform programmes with the help of political influences.

Though, International Financial Institutions (IFIs) endeavoured to change legal framework of Pakistan, however their endeavours could not be productive because of political contrasts between the GOP and the IFIs. The obvious intention of these obstacles by the GOP is to protect the particular groups who have vested interests; as an improved, just and efficient judicial system could be a risk for the politicians being corrupt.

Pakistan is ranked high by Transparency International (TI) in corruption for several previous years. TI ranked the department of Police, Civil Servants, Political Parties and Parliament as the most corrupt institutions in its report published in 2013.⁸⁸ There are a number of corruption cases that can be cited but they are beyond the scope of this thesis. It is obvious that, an autonomous and transformed judicial system can be risky for corrupt individuals and groups holding public offices; hence, they do not allow the legal system to be improved.

In such a situation, the scholars of CG propose a different option to the judicial enforcement mechanism.⁸⁹ As per them, one choice may be to reform and enhance firm-level administration by embracing contracts with more disclosure, protecting shareholder rights, and implementing CCG. They contend that companies with a well and long established CG mechanism may not require resort to a judicial enforcement mechanism. However, the counter argument to this option is that, this substitute to the judicial enforcement mechanism might not be a good choice because of the reason that corporate clashes cannot be discounted due to just existence of rights of shareholders, disclosure and the acceptance of CCG in the MOA and AOA of companies.

⁸⁸ Transparency International <<http://www.transparency.org/gcb2013/country/?country=pakistan>> accessed 15 May 2015

⁸⁹ Leora Klapper and Inessa Love, 'Corporate Governance, Investor Protection, and Firm Performance in Emerging Markets' (2004) 10 *Journal of Corporate Finance* 723

The reason could be the process in which corporate choices are made and companies are worked, the likelihood of contention among the parties permanently exists. If there is an occurrence of a debate, the parties might have option to an impartial forum. The well-established governance mechanism has also to face corporate conflicts, a sound judicial enforcement mechanism is necessary to enforce the laws. Private implementation may be a viable instrument however it would rely on public enforcement.⁹⁰

Therefore, this thesis argues that both of these mechanisms company-level governance mechanism and strong judicial enforcement mechanism are required simultaneously for the better implementation of CG practices in the listed companies of Pakistan; as firm-level administration can be viable just when there is an entrenched judicial or institutional mechanism of enforcement.

Moreover, the judicial organisation and framework is another major problem with enforcement of CG in Pakistan. The judges in general courts are appointed by a competition exam. The candidates can appear in exam after two years of completion of their LLB.⁹¹ The majority of candidates appear in exams have their qualification as LLB, only few have LLM degrees. The CG subject is not included in the curriculum of LLB in Pakistan's law colleges; that's why they lack required skills and knowledge to entertain technical cases related to corporate matters, insider trading, mergers, and acquisitions, takeovers, listing rules and securities laws.

One approach to deal this problem may be to give training to the newly appointed judges in these fields; but this procedure would be lengthy and costly as the price of this procedure will be high when calculated against the potential advantages that this procedure might produce. The reason is that just a few judges are required to deal with corporate matters; therefore it is not prudent to spend a huge

⁹⁰ Ibid (n 40)

⁹¹ On the other hand, the minimum requirement for a person to apply to be a judge in England is five years of practice; however in practice the people who apply for a judicial seat usually have 15-20 years of experience in the legal field. Such practice should be established in Pakistan as well in order to enhance the competency of judges.

amount of money, time and effort on such training. As there is no need to train all judges in corporate matters.

Therefore, to establish the separate specialised corporate courts would be a better idea. This idea is already in debates among the corporate academics of Pakistan. It will require less time and money, as once these courts will be established they will continue to work like this. In this way the efforts are required only once; while in other case judges will have to train every time on their appointment, secondly which judges should be trained, only few or all, it is very confusing and troublesome.

The establishment of separate special corporate courts will advance the enforcement framework relating to corporate matters. The CG framework can operate efficiently if the regulatory bodies have not to depend on the general courts due to many reasons; the most significant is the over-burden of general courts. The judges of corporate courts can be trained accordingly in order to provide them with basic knowledge of corporate matters.⁹² The part of general courts in corporate matters will be reduced only to deal with a legal fault which can be resolved by filing an appeal before general courts.

The practice of establishing special courts for the purpose of enhancing enforcement capability has already taken place in various jurisdictions.⁹³ The Financial Court in China, Commercial Courts in Malaysia, the Financial Reporting Council (RFC) in Hong Kong, the CG Office in the Philippines Stock Exchange, the Enforcement Division in Bursa Malaysia, the Audit Oversight Boards in South Korea and Malaysia, the economic courts in Russia,⁹⁴ labour courts in Germany⁹⁵ and the tribunals in India are examples of special

⁹² Ibid (n 2) 815

⁹³ OECD, 'Corporate Governance in Asia 2011: Progress and Challenges, Corporate Governance' (OECD Publishing 2011) <<http://browse.oecdbookshop.org/oecd/pdfs/product/2611011e.pdf>> accessed 10 May 2015

⁹⁴ Karen Halverson, 'Resolving Economic Disputes in Russia's Market Economy' (1996) 18 Melbourne Journal of International Law 59, 60

⁹⁵ Erhard Blankenburg, 'Patterns of Legal Culture: The Netherlands Compared to Neighbouring Germany' (1998) 46(1) Australian Journal of Corporate Law 23, 25

enforcement frameworks within existing institutions in different parts of the world.

Moreover, the Federal securities law in the US also anticipates administrative courts to improve the enforcement framework.⁹⁶ The establishment of special courts might solve the enforcement issues or possibly uplift the capability to enforce corporate laws.

This practice of establishing specialised courts and tribunals is already in place in Pakistan in different fields under different laws. For example the federal administrative courts and tribunals already working in Pakistan are; Banking Courts,⁹⁷ Anti-Terrorism Courts,⁹⁸ Accountability Courts,⁹⁹ Drug Courts,¹⁰⁰ Special Courts of Emigration Offences,¹⁰¹ Labour Courts,¹⁰² Court of Special Judge (Customs, Taxation and Anti-Smuggling),¹⁰³ Income Tax Appellate Tribunals,¹⁰⁴ Environmental Appellate Tribunals,¹⁰⁵ Insurance Appellate Tribunals,¹⁰⁶ Service Tribunals,¹⁰⁷ Special Courts (Control of Narcotics Substances),¹⁰⁸ Federal Ombudsman (Wafaqi Mohtasib),¹⁰⁹ Federal Tax Ombudsman,¹¹⁰ Federal Insurance Ombudsman,¹¹¹ Commercial Courts¹¹² and Integrated Utility Courts.¹¹³ Moreover, the provincial administrative courts and

⁹⁶ John Coffee, 'Privatisation and Corporate Governance: The Lessons from Securities Market Failure' (1999) 25 The Journal of Corporation Law Studies 29

⁹⁷ Under the Recovery of Finances Ordinance 2001 and The Offences in Respect of Banks Ordinance 1984

⁹⁸ Under the Anti-Terrorism Act 1997

⁹⁹ Under the National Accountability Bureau (NAB) Ordinance 1999

¹⁰⁰ Under the Drugs Act 1976

¹⁰¹ Under the Emigration Ordinance 1979

¹⁰² The Industrial Relation Ordinance 2002

¹⁰³ Under the Customs Act 1969

¹⁰⁴ Under the Income Tax Ordinance 2001

¹⁰⁵ Under the Pakistan Environment Protection Act 1997

¹⁰⁶ Under the Insurance Ordinance 2000

¹⁰⁷ In accordance with the Article 212 of the Constitution of the Islamic Republic of Pakistan under the Services Tribunals Act 1973

¹⁰⁸ Under the Control of Narcotics Substances Act 1997

¹⁰⁹ The Establishment of the office of Wafaqi Mohtasib (Ombudsman) Order 1983

¹¹⁰ Under the Federal Tax Ombudsman Ordinance 2000

¹¹¹ Under the Insurance Ordinance 2000

¹¹² Under the Import and Export (Control) Act 1950

¹¹³ Under the Gas Utility Companies Act 2010

tribunals already existing in Pakistan are; Revenue Courts,¹¹⁴ Consumer Courts, Rent Tribunals,¹¹⁵ Family Courts,¹¹⁶ Services Tribunals,¹¹⁷ Anti-Terrorist Courts¹¹⁸ and Drug Courts.¹¹⁹

The administrative courts, tribunals and the ombudsmen¹²⁰ are working to provide assistance to people in various matters, and are performing better than the traditional judiciary.¹²¹ Therefore establishing corporate courts would help to expedite the enforcement framework in corporate matters which lead towards prevailing of CG practices and improve the corporate sector of Pakistan; as dealing with corporate matters requires expertise and special knowledge; hence, hiring specialists would reduce delays, expense and will prevail justice.

The researcher further submits that, establishing separate corporate courts may help considerably in enhancing the implementation and enforcement of corporate laws but it cannot make a big difference due to many other issues which need to be dealt along with establishing special corporate courts. As mentioned above, there are already several special administrative courts and tribunals working in the country which shows the efficiency of system; then why justice cannot be seen to be done and general society do not have trust in judiciary.

There are many other reasons for this which have been identified above¹²² therefore measures need to be done to resolve these problems as well. For this purpose, this thesis argues that judiciary should be a strong and an independent

¹¹⁴ Under the West Pakistan Land Revenue Act 1967

¹¹⁵ The Punjab Rented Premises Act 2009

¹¹⁶ Under the West Pakistan Family Courts Act 1964

¹¹⁷ Under the Punjab Services Tribunal Act 1974

¹¹⁸ Under the Anti-Terrorism Act 1997

¹¹⁹ Under the Drugs Act 1976

¹²⁰ The Islamic Countries Society of Statistical Sciences (ICSSS), 'Citizen Report Card Study (CRCS) on the Federal Tax Ombudsman (FTO) Pakistan' (Transparency International Pakistan (TIP) <<http://fto.gov.pk/userfiles/TIP%20Report%20-%20A%20Summary.pdf>> accessed 05-01-2015; The Nationwide daily Urdu newspaper *Jhang* reported on 15-12-2011 that the FTO was the most effective accountability office in the public sector; TIP mentioned in the Corruption Perceptions Index 2011 released on 1st December 2011 that the FTO was the cleanest institution in the public sector.

¹²¹ TIP has reported the Pakistani Judiciary as the fourth most corrupt institution after Taxation, Police and Land Administration Departments in its 'National Corruption Perception Survey 2011' <<http://www.transparency.org.pk/report/ncps2011/ncps2011.pdf>> accessed 10-01-2015

¹²² In sections 5.4, 5.4.1, 5.4.2, 5.4.3 and 1.2.1

institution; therefore it should be separated from the Executive according to the Constitution.

This thesis challenges the 19th amendment of the Constitution which is done to limit the judicial authority of superior courts and control the judiciary by the Executives. The appointment, qualification and remuneration of superior courts' judges should be done according to the constitution as was before the 19th amendment not through the Executives.

Likewise, the removal of a judge should also be by SJC according to the Constitution without any interference or influence of the Executive. As if judiciary could not be separated from the Executives it can never be independent and cannot do justice. How could judicial system be just if it could not prevail rule of law? Therefore, in order to get a reformed and independent judicial system it should be free from any political influence.

Furthermore, this thesis argues that, some ethics and code of conduct should also be formulated for the retired judges of superior courts, that they should not be involved during or after their retirement in any political matters. The former CJ of Pakistan Mr Iftikhar Chaudhary has established his own political party after his retirement and has formally started politics. During his tenure as a CJ of Pakistan, he decided some important cases and gave historical judgements. The people of Pakistan had great respect for him and started trusting judiciary due to him. But sadly, after his retirement several news channels revealed his and his son's involvement in many corruption scandals with government, his relations with political parties and now finally he launched his own political party. This practice is wrong. A judge should always be a judge and behave like a responsible person. Judges should not be allowed to participate in any political practices.

Moreover, as discussed in chapter four that the commissioners of SECP are appointed by the government. The large listed companies are either under state control or family-owned, and those families also have strong political relations. In such environment the appointment of independent commissioners is also difficult. Therefore, the policy makers should devise a mechanism independent from

political influence for the appointment and removal of the commissioners of SECP which is an important institution of corporate sector of Pakistan.

Last and probably the most significant concern is to enhance judicial efficiency and capacity. This thesis argues that it can be done by increasing the number of judges. The argument is that, with increasing the number of judges the burden of courts will be balanced which serve two purposes; one it can enhance the judicial efficiency and capacity when the courts will have reduced number of cases for each judge to handle on daily basis. They will have more time to give each case and as a result the quality of judgements will also improve.

Secondly, it will also reduce unemployment. However, the more important issue in this regard is the appointment procedure of judges. Judges should be appointed through a fair mechanism on merit; otherwise only increasing numbers by appointing more judges will not serve the purpose; as quality is more important and it should not be compromised for the sake of quantity.

5.5 The Role of Capital Market in Corporate Governance

The capital market of Pakistan is also an important area of concern for effective enforcement in corporate matters. The market is not as efficient as required,¹²³ and fails to punish companies performing badly and to their directors responsible for bad performance of companies. A market with frail enforcement framework permits market control and seizure of minority and individual investors by overwhelming business groups having large shareholdings. In the absence of a reformed and efficient market the principles of CG cannot grow.

The market reform was started with the establishment of an authorised and independent regulator the SECP (as discussed in chapter one and four). The launch of SECP was the major breakthrough in this respect. However, the disappointment of business sector to uphold shareholders' security and penalise

¹²³ Ghani and Ashraf (n 19) 19

bad performing companies remained the major worry. As a result, some reforms were undertaken in the stock markets.

During the first phase of reform, the central depository company (CDC) was established for the supervision of significant securities under the Central Depositories Act, 1997 and the Central Depository Companies (Establishment and Regulation) Rules, 1996.

In the second stage of reform, the stock market was demutualised and transformed from a company limited by guarantee to a company limited by shares and opened it for public trade. According to the rules, the stock market was to be corporatized, and integrated by the end of 31 December 2006,¹²⁴ which has not been done yet due to the slow legislative process in Pakistan.

During the third phase of reform the insider trading's rules were modified. The new meaning and description of insider trading was introduced in the securities law.¹²⁵ The sentence for insider trading was changed from imprisonment and fine to just fine in order to transform criminal liability to civil liability. The reason of this conversion was that, the form of proof required in criminal matters is much severer in contrast to civil matters, as evidence beyond doubt is required to prove a criminal offence, which might not be possible to get in most of corporate cases and white-collar crimes.

In a further step, the CCG was issued and made it part of the listing requirements in 2002 and revised in 2012; however it could not be adopted and implemented by companies in its true sense.¹²⁶

The researcher contends that the steps taken by the regulators to reform corporate sector are encouraging but these reforms are not sufficient to develop the market and improve CG, there is a lot needs to be done. For this purpose, one way could be the phased implementation of CCG. For this purpose, the stock market can be

¹²⁴ S. 32E (1) of the Securities and Exchange Ordinance 1969

¹²⁵ The Securities and Exchange Ordinance 1969

¹²⁶ As identified in section 1.2.1, 1.2.2 and in chapter four.

distributed in divisions. Every division may have its own requirements depending upon the nature of the listing as done in the UK. This can avoid the resistance from family-owned businesses and other interested groups. The idea of dividing Pakistan's stock market in two segments is already in debates among corporate academics; however this thesis advocates the idea of dividing Pakistan's stock market in three segments, as it will create a more competitive environment which will result into the better compliance with the CCG.¹²⁷

The following sections discuss some options through which the capital market of Pakistan can be reformed in order to make the compliance of the CCG better to achieve good CG standards.

5.5.1 Lessons from London Stock Exchange (LSE)

The example of dividing stock market into different fragments is already in place in several countries, of which the LSE presents a vital model. The LSE is divided into diverse divisions, named as the premium listing and the standard listing. The large UK and overseas companies, including the European Economic Area (EEA), might have any of these two listings, as well as global depository receipts (GDRs).¹²⁸ It relies on the decision of the issuer/regulator and, in this manner the requirements must be satisfied as required for the respective listing.¹²⁹

The companies who trade equity shares and closed and open-ended investment entities can have premium listing, while the standard listing incorporates the issuance of shares, depository receipts, debts and securitised derivatives.¹³⁰

Premium listing does not signify 'first listing' or 'sole listing' instead, it implies that companies who wish to have premium listing are bound to fulfil the most elevated benchmarks of regulation and disclosure requirements in Europe.

¹²⁷ The detail of this point is mentioned below.

¹²⁸ <<http://www.fsa.gov.uk>>; <<http://www.fca.org.uk/>> and <<http://www.bankofengland.co.uk/prd/pages/default.aspx>> accessed 10 January 2015

¹²⁹ Financial Services Authority, 'A Review of the Structure of the Listing Regime' (Discussion Paper 08/1, January 2008 London)11

¹³⁰ LSE, <<http://www.londonstockexchange.com/companies-and-advisors/main-market/companies/primary-and-secondary-listing/listing-categories.htm>> accessed 10 May 2015

Meaning thereby, they are bound to follow the gold standards of the UK: termed as ‘super-equivalent requirements’ that are higher than the ‘directive-minimum’ standards. Companies having premium listing are possibly qualified for the FTSE UK Index Series, which comprises the well-established and famous FTSE 100 Index.¹³¹

Similarly, the standard listing does not signify a second listing; however, it specifies that the company has preferred to follow EU co-ordinated requirements in contrast to the UK super-equivalent standards necessary for a premium listing. Companies having standard listing are required to follow the ‘directive-minimum’ requirements.¹³² Since April 2010, it is essential for companies who opted standard listing to obey the EU Company Reporting Directive (EUCRD) which necessitates, that a CG declaration should be revealed including key elements of internal control and risk management frameworks be defined among other things, according to the standard listing and GDR.¹³³

The conditions for standard listing are prescribed in the Prospectus and Disclosure and Transparency Rules (DTRs). Moreover, the company has to adopt additionally the Consolidated Admissions and Reporting Directives (CARD) standards and; publish its disclosure statements via the Regulatory Information Services (RIS) in the UK.¹³⁴

The GDRs are debatable securities that describe companies’ equity allotted by a depository bank in the interest of a company, which is usually a foreign company. The objective of issuing GDRs is to raise capital, expand investment, enrich the image of company internationally, assist mergers and acquisitions, and to escalate the publicity of its goods and services. GDRs are usually required to be acquired by professional investors such as IIs in the primary market. The brochure

¹³¹ Ibid

¹³² Ibid (n 130)

¹³³ FSA website: <<http://www.fsa.gov.uk/pages/Doing/UKLA/pdf/listing-regime-faqs.pdf>> accessed 10 May 2015

¹³⁴ Ibid

evidently provides that ‘the securities can just be traded by shareholders who have experience and skills to deal with investment issues’.¹³⁵

The GDR is a professional market; its securities are not incorporated in the FTSE UK index series. These listings are usually offered to foreign companies and which necessitates ‘directive-minimum’ requirements. However, the UK companies can also have listing under GDR, if their original listing is premium.¹³⁶ Similarly, the Specialist Fund Market (SFM) is a specialised market of the LSE and deals with institutional, skilled, knowledgeable and expert investors.¹³⁷

Moreover, the Professional Securities Market (PSM) and the PLUS Quoted Market (PLUSQM)¹³⁸ are also essential fragments of the LSE and worked inside the choice of their position as a Recognised Investment Exchange. The PSM facilitates companies to elevate capital via listing of specialist securities, comprising debt and depositary receipts, to professional investors.

In addition to this, LSE also has international market for smaller emerging companies called the Alternative Investment Market (AIM). An extensive variety of companies, involving, venture capital, new emerging and conventional companies join AIM looking for entrance to develop capital.¹³⁹

The PSM and PLUSQM are non-listed and non-regulated markets. The companies who are allowed to do business but are not included in the official list can trade on AIM and PLUSQM. These both markets do not require compliance with the UK CCG, instead required to comply with sub-directive standards.

The researcher submits that the stock market of Pakistan can be reformed by dividing it into different segments along the lines of the UK. It can be distributed into three portions with primary, secondary and third listing.

¹³⁵ Ibid (n 133)

¹³⁶ Ibid (n 133)

¹³⁷ LSE website (n 30)

¹³⁸ PLUS market group is a UK electronic stock exchange based in London for small Cap companies that was acquired by ICAP and rebranded as ICAP Securities and Derivatives Exchange (ISDX).

¹³⁹ LSE Website: <<http://www.londonstockexchange.com/companies-and-advisors/aim/aim/aim.htm>> accessed 10 May 2015

The primary listing might have condition to adopt international CG standards, more disclosure standards, full and strict obligatory adoption and implementation of CCG. The secondary listing might require adopting only local CG standards, less disclosure standards and voluntary adoption and implementation of CCG. However, the third listing could be for smaller and new companies as is the UK's PSM and PLUSQM non-listed and non-regulated; and companies falling under this category have to follow sub-directive standards.

This division of stock market will not affect families and other groups who do not like reforms as it weaken their control. Families and interested groups who have objections about the adoption and implementation of CCG because of their personal stakes will not be specifically influenced by this sort of change. They might continue their listing on the secondary market and might shift to the primary market when they realise the probable advantages of primary listing with its developed higher standards. This might be useful in adding to the business sector and developing CG standards in Pakistan.

The primary market can be alluring for multinational and large local and foreign companies. These companies can set standards for other companies listed on secondary market and signal to investors about their willingness to adopt CG highest standards. This might additionally encourage other companies listed on secondary market to shift towards primary listing. This practice will assume a noteworthy part in encouraging companies to shift from secondary to primary listing and in other words to follow the higher disclosure requirements and CG standards.

Family-owned, SOEs and new listed companies can choose to have secondary listing which will require less disclosure and voluntary adoption of CCG. New and small companies may choose to stay on third listing which will require voluntary compliance with CCG instead the only requirement to follow the MOA and AOA of their companies and ensure no harm to potential shareholders and other stakeholders. Subsequently, when the business of such companies starts

growing and they realise the potential benefits of stricter compliance with CCG, they can shift towards secondary or primary listing.

The division of stock market into segments will provide companies with exposure and advantages attached to the adoption of CCG and will create an environment of competition. Compliance with fewer requirements may induce management of family-owned businesses and SOEs to consider about shifting to the stricter compliance with CG standards. Reputation and increased shareholder confidence might be the incentives for primary listing. The PICG, credit rating agencies, financial press, print and social media and IIs can play a considerable role in this regard.

The rating agencies and press by praising and increasing the ratings of companies listed on primary market for stricter compliance. The IIs will prefer to invest in companies listed on primary market being professionals who understand the benefits of compliance with CG principles which will provide incentives to other companies listed on secondary markets to switch on primary market even to third market companies. This shift will enhance shareholders confidence and guarantee them the dedication of companies towards the adoption of higher governance standards.

It will additionally enhance the share price of companies. Shareholders' security will be enhanced and higher CG standards will be guaranteed. Minority shareholders might consider it advantageous to invest in primary market being ensured about the protection of their funds, while IIs might make their investments in both markets because of having knowledge and expertise in investing. Likewise, they can also force their investee companies towards stricter compliance. Such environment will also influence block-holders such as families and state functionaries to switch towards stricter compliance when they will see the tangible and substantial benefits of stricter compliance.

Moreover, the creation of such a competitive environment through dividing the stock market will also reduce the burden of regulators in making their efforts to improve the implementations and enforcement of CG principles for the corporate

sector of Pakistan, by providing them incentives to switch towards stricter compliance.

5.6 Conclusion

This chapter has examined the implementation and enforcement mechanism of CG in Pakistan. The factors responsible for the unsuccessful implementation of CG principles in Pakistan have been identified in this chapter. The current chapter established that, the protection of shareholders' interests is paramount in good CG systems and essential for the growth of a market. Corruption, inefficiency, cost, excessive and unreasonable adjournments in deciding cases, absence of expertise and capability on the part of judges and most importantly the political interference in every institutions of the country including judiciary and the capital market are key hurdles to effective enforcement of CG rules and regulations and shareholders' rights in Pakistan.

This chapter formulated recommendations to reform and improve the role of judiciary in relation to enforcement of corporate matters and the implementation of CCG in Pakistan. The current chapter also provided measures to reform the capital market of Pakistan through which the adoption and implementation of CCG could be improved in the corporate sector of Pakistan.

The next chapter deals with the third objective of this thesis and explores the role of BODs in promoting CG practices in the listed companies and develop a board effectiveness model for the listed companies of Pakistan.

CHAPTER SIX: THE ROLE AND EFFECTIVENESS OF CORPORATE BOARD IN PROMOTING CORPORATE GOVERNANCE

6.1 Introduction

The previous chapter explored the measures to improve the implementation and enforcement of corporate governance (CG) principles in Pakistan. The current chapter relates to the third objective of this thesis, which is to examine the role of board of directors (BODs) in promoting CG practices and to develop a 'board effectiveness model' for the listed companies of Pakistan. This chapter examines the effectiveness of BODs in generating shareholder value in Pakistan and to examine characteristics that affect good CG practices. This investigation is significant because of the fact that, a sound and strong internal framework of CG, for example BODs and internal controls help in aligning the interests of directors and shareholders,¹ and the corporate board is seen as a central part of any internal CG structure.²

¹ Michael Jensen and William Meckling, 'Theory of the Firm: Managerial Behaviour, Agency Cost and Ownership Structure' (1976) 3(4) *Journal of Financial Economics* 305; Eugene Fama, 'Agency Problems and the Theory of the Firm' (1980) 88(2) *The Journal of Political Economy* 288; Netter *et al.*, 'The Rise of Corporate Governance in Corporate Control Research' (2009) 15 *Journal of Corporate Finance* 1

² Martin Lipton and Jay Lorsch, 'A Modest Proposal for Improved Corporate Governance' (1992) 48(1) *Business Lawyer* 59; Kose John and Lemma Senbet, 'Corporate Governance and Board Effectiveness' (1998) 22(3) *Journal of Banking and Finance* 371; Igor Filatotchev and Brian Boyd, 'Taking Stock of Corporate Governance Research While Looking to the Future' (2009) 17(3) *Corporate Governance-An International Review* 257

The main role of BODs is to ensure the performance of a company's management.³ This normally implies five functions: direction (advice), executive action (strategy), service and resource support (resource dependence), supervision (monitoring) and accountability.⁴ However, in order to safeguard the interests of shareholders, corporate boards should be effective and efficient in performing their responsibilities.⁵ The previous studies evidenced⁶ that effective and efficient workings of BODs are impacted by several aspects, such as board diversity, composition and size amongst others. Therefore, this chapter examines the effectiveness of BODs by investigating three attributes the diversity, size and composition of BODs.

By doing this, the researcher intends to explore: how corporate boards in Pakistani companies can be made more effective and efficient to promote CG principles and to improve the activism of institutional investors (IIs) which ultimately benefit corporate performance of companies; how does CG practices affect investor perception, corporate strategy and performance; what are the important CG attributes that influence performance of directors in order to meet shareholder expectations; and what is the role of independent non-executive directors (INEDs) in creating shareholder value.

Moreover, it is worth mentioning here that this chapter would be a meaningful contribution to knowledge as there is no such work done previously to investigate the effectiveness of BODs and their role in promoting the CG practices in Pakistan. The following figure shows the plan of this chapter.

³ Ibid

⁴ Rossouw *et al.*, 'Corporate Governance in South Africa' (2002) 37(3) *Journal of Business Ethics* 289; Niamh Brennan, 'Boards of Directors and Firm Performance: Is there Any Expectation Gap?' (2006) 14(6) *Corporate Governance* 580

⁵ Michael Jensen, 'The Modern Industrial Revolution: Exit and the Failure of Internal Control Systems' (1993) 48(3) *The Journal of Finance* 831

⁶ David Yermack, 'Higher Market Valuation of Companies with a Small Board of Directors' (1996) 40(2) *Journal of Financial Economics* 185; Nina Baranchuk and Philip Dybvig, 'Consensus in Diverse Corporate Boards' (2009) 22(2) *The Review of Financial Studies* 715

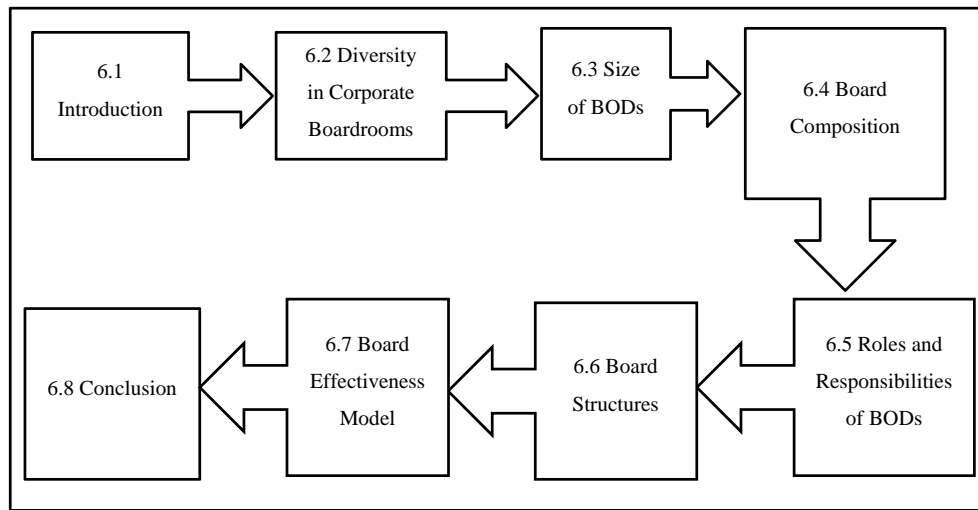


Figure 6.1: Plan of this Chapter

6.2 Diversity in Corporate Boardrooms

6.2.1 The Theoretical Link between Diversity in BODs and Corporate Performance of a Company

Board diversity is characterised⁷ as the different properties signified among BODs regarding board operations and decision-making, comprising age, gender, ethnicity, culture, religion, independence, knowledge, educational and professional background, technical skills and expertise, commercial and industry experience.

There are two differing views in regards to the effect of diversity of BODs on maximising shareholder wealth and performance of companies: one group advocates that more diverse corporate boards are better; and other group advocates corporate homogeneity and uniformity better for corporate boards.

⁷ Nicholas Van der Walt and Coral Ingley, 'Board Dynamics and the Influence of Professional Background, Gender and Ethnic Diversity of Directors' (2003) 11(3) Corporate Governance: An International Review 219

The proponents and exponents of more diverse and less diverse BODs generally argue on the basis of agency, resource dependence, signalling and stake-holding theories.⁸

Agency theory advocates that BODs having varied backgrounds rather than homogenous groups having similar socio-economic backgrounds enhances independence of BODs and directors' monitoring.⁹ It creates variety in ideas, perspectives, experience, and business knowledge to the decision-making process in boardrooms.¹⁰ This can facilitate for better assessment for the difficulties of the corporate outer atmosphere and business sector. It can likewise build innovativeness and developments in meeting rooms because of divergent qualities in intellectual capacities, which can likewise encourage powerful and influential decision-making.¹¹

Moreover, resource dependence theory specifies that diversity in BODs helps to associate a company to its outside atmosphere and secure skills, business contacts, good reputation and acceptability.¹² Additionally, more diverse corporate boards may signal positively to potential job applicants.¹³ This will help to attract educated and skilled persons from the circles from where the candidates for BODs are generally recruited. This can also generate healthy competition within the company's internal labour sector.

This will also help ethnic minorities and women to apprehend that they are not omitted from the top positions in the company.¹⁴ Finally, BODs comprising on skilled and competent persons of various credentials can deliver a developed relation with companies' partners, including consumers and the local community.

⁸ Goodstein *et al.*, 'The Effect of Board Size and Diversity on Strategic Changes' (1994) 15 Strategic Management Journal 241; Carter *et al.*, 'Corporate Governance, Board Diversity, and Firm Value' (2003) 38(1) The Financial Review 33

⁹ Jensen and Meckling (Ibid 1) 307

¹⁰ Jensen and Meckling (Ibid 1) 307

¹¹ Carter *et al.* (n 8) 36

¹² Baranchuk and Dybvig (Ibid 6) 718

¹³ Caspar Rose, 'Does Female Board Representation Influence Firm Performance? The Danish Evidence' (2007) 15(2) Corporate Governance: An International Review 405

¹⁴ The issue of Women on Board is addressed in detail in the next section.

This can enhance companies' reputation and business prospects.¹⁵ For instance, by coordinating the differing qualities of a company's BODs to the differing qualities of its clients and suppliers, it can essentially expand its capacity to enter competitive business markets.¹⁶

Conversely, the advocates of organisation theory assert that differing attributes in BODs can affect the performance of companies negatively.

Firstly, it has been advocated that BODs with more differing attributes might not as a matter of course result in more compelling control and decision-making process. The reason is that the members of diverse board might be elected as an indication of tokenism, and therefore their commitments might be limited.¹⁷

Secondly, organisation theory designates that differing qualities in the BODs might altogether limit its endeavours to make definitive move and start vital changes, particularly in times of weak corporate performance and natural instability.¹⁸

Thirdly, the members of diverse BODs might pass their individual and communities' stakes and responsibilities to corporate board.¹⁹ The more prominent assorted qualities of these stakes will prompt the more noteworthy potential for clashes and factions to emerge.²⁰ This can restrain meeting room consistency and execution of tasks.²¹

The final argument is that the suggestion that company BODs ought to be established in order to imitate all their important partners and society in general is inconsistent with the idea of business.²² This is on account of, if board individuals

¹⁵ Shrader *et al.*, 'Women in Management and Firm Financial Performance: An Exploratory Study' (1997) 9(3) *Journal of Managerial Issues* 355

¹⁶ *Ibid*

¹⁷ Rose (n 13) 406

¹⁸ Goodstein (n 8) 243

¹⁹ Barry Baysinger and Henry Butler, 'Corporate Governance and Board Directors: Performance Effects of Changes in Board Composition' (1985) 1(1) *Journal of Law, Economics and Organisation* 110

²⁰ Baranchuk and Dybvig (n 6) 725

²¹ Goodstein (*Ibid* 8) 243

²² Rose (n 13) 405

are not chosen on the basis of their capability to add considerably to the decision-making procedure of BODs, *ceteris paribus*, will result in the creation of varied but comparatively ineffective larger BODs. This can impact negatively on the financial performance of companies.

However, this researcher argues that, the notion of board ‘diversity’ is different than ‘larger’ boards. Therefore, if larger boards are comparatively ineffective, this cannot be related to board diversity. The researcher claims that diverse boards are more expected to enhance and improve a company’s corporate and financial performance due to their varying expertise and different dimensions of their backgrounds and knowledge in corporate matters. Board diversity can have a real impact on CG attributes such as monitoring, as it can bring more independence in BODs.

The reason is that the idea behind making boards diverse is and/or should be to make combination to bring different experiences and backgrounds. Such boards can take more risks as they would have the ability to handle those risks, would monitor the strategic decision-making of BODs, in other words such boards would more able to make their evaluation and likewise, there would be less chances of expropriation of shareholders’ interests particularly of minority shareholders. Therefore, the diverse corporate boards can contribute meaningfully to promote CG of corporations.

6.2.2 The Empirical Evidence on the Association between Diversity of BODs and their Outcome

The diversity in BODs is one of the under researched board attributes,²³ however it is now drawing attention of corporate scholars and business community to explore this attribute of board.²⁴ This makes it a productive area for future studies, particularly in Pakistan where there is a dearth of board diversity studies. This section reviews the previous empirical studies to identify the effect of diverse

²³ Ibid (n 6)

²⁴ Ibid (n 6, 13); Francoeur *et al.*, ‘Gender Diversity in Corporate Governance and Top Management’ (2008) 81 Journal of Business Ethics 83

corporate boards on the corporate performance of their companies; and then explore how diverse corporate boards influence the listed companies in Pakistan in order to improve CG practices there.

Using a small sample of 25 American Fortune 500 companies, a positive relationship was found between companies that utilise a higher rate of women in top administration, including Return on Assets (ROA), Return on Equity (ROE), Return on Investment ROI and Return on Sales (ROS).²⁵ However, this study received criticisms for its small sample, focusing mainly on large companies.²⁶ Nevertheless, it proves the fact that diversity in corporate boards has positive relationship with companies' performance.

Moreover, a positive relationship was also reported between board diversity²⁷ and market measure of performance²⁸ in another study utilising a bigger sample of 638 American Fortune 1000 companies in 1997. This study proposes that US companies with greater percentage of females and ethnic minorities on their BODs produce greater financial and corporate performance. The companies having higher percentage of women officers reported that companies functioning in complex and difficult environments do produce positive and substantial unusual profits.²⁹

Likewise, utilising a cross-sectional sample of 117 South African listed companies in 2003, a noteworthy affirmative relation between the proportion of ethnic individuals³⁰ on corporate boards' and intellectual capital performance was reported.³¹ It is argued that if diverse boards perform better than their non-diverse counterparts, it should ultimately reflect in their financial bottom line.³² To

²⁵ Roy Adler, 'Women in the Executive Suite Correlate to High Profits' (2001) Glass Ceiling Research, <<http://www.glass-ceiling.com>> accessed 20-02-2015

²⁶ Ibid (n 24)

²⁷ Measured by gender and ethnicity

²⁸ Ibid (n 13) 408

²⁹ Eugene Fama and Michael Jensen, 'Separation of Ownership and Control' (1983a) 26(2) Journal of Law and Economics 301; 'Agency Problems and Residual Claims' (1983b) 327

³⁰ Non-whites

³¹ Swartz N-P and Steven Firer, 'Board Structure and Intellectual Capital Performance in South Africa' (2005) 13(2) Meditari Accountancy Research 145

³² Ibid

capture the impact of possible changes in board diversity over time, the sample period used in this study is also longer: 2002-2006. The analysis in this study can also provide new valuable visions relating to the differing qualities of BODs and the financial performance relationship literature.

In contrast, some studies reveal that board differing qualities effect adversely on financial and corporate performance. An investigation was held regarding the effect of board having divergent attributes on a company's aptitude to start vital modifications in an aggregate of 335 American companies from 1980 to 1985.³³ It was found that companies with varied boards usually pledge less policy alterations as compared to homogenous boards. This suggests that diversity in BODs generates clashes, which minimise the capacity of BODs to initiate vital reforms in appropriate time.

A similar study was conducted on 200 American Fortune 500 companies in 1992, in order to find the association between two accounting measures of financial performance (ROA and ROE) and the proportion of female members of board.³⁴ The results of that suggest a significant and adverse connection between the companies' performance and proportion of women on the board. It was argued that women on board might be underestimated; their existence might likewise have financial costs repercussions to the company.³⁵ This implies they might not be making any significant commitments to the decision-making of corporate board; however receiving their financial emoluments regularly. This might have adverse effect on the financial performance of companies, and thus helps in explaining the negative female board members-financial performance link.

However, the researcher submits that this may not be true in all circumstances. The study³⁶ has not provided any particular evidence regarding women not making any meaningful contribution but receiving their pay. If that study talks about in any particular circumstance or time span during which women did not

³³ Ibid (n 6)

³⁴ Ibid (n 15)

³⁵ Ibid (n 15)

³⁶ Ibid (n 15)

contribute, it can happen in men's case as well. For example, if women are not capable to deal with company's matters properly, all men may also not so capable. Only one reason can be understandable and that is during maternity leave. However, this is not justified to challenge the contribution of women on the basis of such particular time-span.³⁷ Moreover, in the normal course of time women may handle corporate matters in more efficient way and contribute more than some men. The results of some empirical studies³⁸ show that the more diverse boards with higher proportion of women in top administration have positive effect on the performance of companies.

The topic of women on BODs is currently a 'hot' debate and it is being considered in almost all parts of the world to increase the percentage of women in their corporate boards. For example, France, Italy and the UK are taking considerable actions for this and Spain, Norway and Australia have already made significant steps in this. Norway has already achieved its target and made 40% women representation compulsory in corporate boards. Norway has made this the mandatory disclosure requirement for all listed companies to disclose their board diversity; if a company do not follow this requirement that company has to face closure.³⁹

In 2004, the proportion of women in corporate boards of FTSE 100 companies of the UK was 9.4% which increased to 12.5% in 2010. However, the ratio of this increase is slow. The Equality and Human Rights Commission (EHRC) report⁴⁰ claimed that according to this speed, it will take more than 70 years to the UK's top FTSE 100 companies to achieve a gender balanced boardrooms. Considering the importance of more women on corporate boards recommendations were formulated in 2011 for the FTSE 100 companies of the UK along the lines of

³⁷ This point has multiple dimensions to discuss and beyond the scope of this research, that is why cannot be discussed in detail here.

³⁸ Ibid (24, 15)

³⁹ Lessons from Norway in Getting women onto Corporate Boards, <<http://theconversation.com/lessons-from-norway-in-getting-women-onto-corporate-boards-38338>> accessed 20 December 2015

⁴⁰ Report of the Equality and Human Rights Commission (2008)

Norway, and a target was set to achieve 25% of women on boards by 2015.⁴¹ By March 2015, the ratio of women increased to 23.5% and it is hoped that the target will be achieved by the end of year 2015.⁴² According to Lord Davies,⁴³ corporate boards perform better if they consist upon a range of backgrounds and perspectives. The responsibilities of BODs are to take strategic decisions, overlook risks and monitor governance; therefore it is imperative that BODs should have competent high calibre individual offering mix of skills, experiences and backgrounds.

Therefore, the importance of women cannot be denied; in fact the ratio of women qualifying from universities with higher grades has increased remarkably and is increasing continuously, but sadly women are so under-represented in corporate boards and hence companies are missing out a widest range of possible talent. Therefore, time has come to acknowledge the importance of gender balance corporate boards on a belief that gender balance boards perform better than those who are not gender balanced.

South Africa presents a motivating research background to discover the influence of diverse board's on companies' performance. It has an ethnically diverse populace (i.e., made up of people from almost every part of the world, including European Whites or Caucasians, Chinese, Indians, Mixed Race and Black Africans). An affirmative action laws meant to address the negative social and economic legacies of Apartheid have been introduced since 1994. Central to the affirmative action legislation is ensuring that non-whites, especially black men and women, are appointed to positions of significance in South African companies.⁴⁴ The researcher submits that examining board diversity under this

⁴¹ Women on Boards February 2011, <https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/31480/11-745-women-on-boards.pdf> accessed 20 December 2015

⁴² Women on Boards Davies Review Annual Report (2015), <https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/415454/bis-15-134-women-on-boards-2015-report.pdf> accessed 20 December 2015

⁴³ Ibid (n 42)

⁴⁴ Institute of Directors Southern Africa, 'South Africa is a Leader in Gender Diversity on Corporate Boards, Says New Study' (2013) <<http://www.iodsa.co.za/news/135560/South-Africa->

context can arguably bring new insights that may enrich the board diversity-performance literature.

One of the most noteworthy internal CG concerns presently encountering companies in South Africa is board diversity and its effect on corporate performance.⁴⁵ The South African Employment Equity Act 1998 stipulates that every firm with more than 100 employees should ensure that its labour force, including top management is constituted by a balance between non-whites and whites. Among the non-whites, black men and women are expected to be given special preference.⁴⁶

By contrast, King II and the JSE's Listings Rules do not fix any particular goals for companies. However, they suggest that each company should ponder whether its board is sufficiently varied in terms of skills (profession and experience) and demographics (age, ethnicity and gender). This can confirm that the alignment of South African corporate boards imitate the assorted South African background, and make them effective. They also encourage companies to observe the provisions of the Employment Equity Act.

This indicates that King II anticipates that the diversity of board have affirmative impact on the corporate performance of companies. South African listed companies significantly enhance their intellectual capital performance by having ethnically diverse BODs.⁴⁷ If diverse boards perform better than homogenous boards, then they are likely to generate significantly higher corporate and financial performance. King III does not speak about board diversity issue, so the recommendations of King II are prevalent in this regard.

The CCG 2012 of Pakistan speaks about board diversity⁴⁸ that, it is preferred and encouraged for BODs to be diverse having a balance of executive and INEDs

[is-a-Leader-in-Gender-Diversity-on-Corporate-Boards-says-New-Study.htm](#)> accessed 20 January 2016

⁴⁵ Ibid (n 13)

⁴⁶ Chapter II, Section 5, 6 of the South African Employment Equity Act 1998.

⁴⁷ Ibid (n 31)

⁴⁸ Clause (i) of the CCG 2012 of Pakistan

including a balance of male and female members representing the interests of minorities with their experience, skill and knowledge so that the company's operations could be managed in more diligent and efficient way. However, these provisions are voluntary in nature not mandatory for corporations, and face similar problems in their implementation as discussed in chapter four and five.

According to an estimate⁴⁹ the ratio of women on corporate boards in Pakistan in 2009 was just 4.6%, however, it is not clear on which companies' boards this ratio of women was estimated. However, in 2010 the percentage of women on corporate boards of 303 public listed companies was only 13%.⁵⁰

Mr Zaffar Khan, former president, chairman and director of many high profile public listed companies of Pakistan said in one of his interview that during my work experience of over 30 years in different companies as a president, chairman and director, my experience to deal with such BODs having women representation is very limited. He said during the time when he was board member of Pakistan's Central Bank, the chairman was a woman, and at Unilever Pakistan, the chairperson was a women and she was the only women on board. He observed that the corporate board run by women is tough driven, more disciplined and sharply focussed, even then the women representation on corporate boards is very limited.

He also responded in an interesting way, that if I imagine being only one male member on board among all other female members, I will feel embarrassed, less confident and would not be able to show and use my skills and abilities properly. Therefore, the ratio of women on corporate board should be balanced with the ratio of their male counterparts. He also observed that the women coming to boards and having business degrees usually have more good grades than males. The researcher submits that, the time has come to change the mind set of male

⁴⁹ Women on Boards: A Statistical Review by Country, Region, Sector and Market Index; Governance Metrics International; March 2009

⁵⁰ A Global Corporate Governance Publication Forum, 'Focus Women on Boards: A Conversation with Directors'
<http://www.ifc.org/wps/wcm/connect/b51198804b07d3b2acabad77fcc2938e/Focus9_Women_on_Boards.pdf?MOD=AJPERES> accessed 20 December 2015

dominated corporate boards and establish equilibrium of both genders in order to get the most of their skills, experiences and new talent which will transform Pakistani companies for the better.

6.3 Size of BODs

6.3.1 The Theoretical link between the Size of BODs and Corporate Performance

Corporate board size is considered to be one of the most important board attributes.⁵¹ The existing literature provides a theoretical and empirical connection between performance of companies and size of their BODs with mixed results.⁵²

Agency theory declares larger board bad for the performance of a company however, smaller boards effective and good for improving companies' performance, which ultimately affect CG practices.⁵³ It is believed that smaller boards enhance their performance regarding oversight duties while; larger boards incline to accentuate graciousness and courtesy instead of truth and frankness in boardrooms.⁵⁴ Another argument is that big board exacerbate agency problems which make board more symbolic and they neglect their monitoring and controlling duties.

Another study⁵⁵ supports this view as; the possibility of fraud and other irregularities increases with the increase of board size, which entails the necessity for enlarged monitoring with larger boards. Furthermore, when the size of corporate board increases above a maximum number of ten directors, it incurs extra expenses of having larger boards normally results in slow decision-making and requires deep monitoring of management's actions.

⁵¹ Coles *et al.*, 'Boards: Does One size Fit All' (2008) 87(2) Journal of Financial Economics 329

⁵² Ibid (n 2, 6)

⁵³ Ibid (n 2); Jeffrey Sonnenfeld, 'What Makes Great Boards' (2002) 80(9) Harvard Business Review 108

⁵⁴ Ibid (n 39)

⁵⁵ Mark Beasley, 'An empirical analysis of the relation between the board of director composition and financial statement fraud' (1996) 71(4) The Accounting Review 443

Firstly, this is because while BODs plan, organise, direct and control the business of the organisation, the size of the board has also got financial costs implications. That is, *ceteris paribus* bigger boards guzzle more pecuniary and non-pecuniary resources of a company by way of remuneration and privileges than smaller boards.

Secondly, the bigger board not only lacks co-ordination but also comes under control of CEO easily due to free-riding and related director dodging.⁵⁶ Therefore, the size of corporate board must fall between eight and nine directors preferably.⁵⁷

Thirdly, it is contended⁵⁸ that smaller boards are expected to be more unified, and to have more effective negotiations. Therefore, all executives get the opportunity to frankly contribute and exchange their views within the specified time.⁵⁹ It is worth remembering here that the proponents of smaller corporate boards mainly draw their inspiration from organisational theory, which posits that the groups become less effective when they grow in size due to the associated co-ordinated issues have a tendency to exceed the advantages picked up from having a larger group of skilled people to draw from.⁶⁰

Lastly, the larger boards experience the ill effects of higher agency issues and are far less influential than smaller boards.⁶¹ Thus, limiting corporate board size may improve efficiency.

The opposite view confers that, the larger board relatively has more capability to monitor the acts of administration successfully as compared to the smaller ones.⁶²

The exponents of this view argue that, companies with development chances,

⁵⁶ Jensen (n 1) 865

⁵⁷ Lipton and Lorsch (n 2) 67

⁵⁸ Ibid (n 8)

⁵⁹ Ibid (n 8)

⁶⁰ Ibid (n 2, 4); Ivan Steiner, *Group Process and Productivity* (Academy Press New York 1972) "See generally"; Jeffery Pfeffer, 'Size, Composition, and Function of Hospital Boards of Directors: A Study of Organisation-Environmental Linkage' (1973) 18 *Administrative Science Quarterly* 349; Richard Hackman, *Groups that Work* (San Francisco: Jossey-Bass Canada 1990) "See generally"

⁶¹ Alfred Yawson, 'Evaluating the Characteristics of Corporate Boards Associated with Layoff Decisions' (2006) 14(2) *Corporate Governance-An International Review* 77

⁶² John and Senbet (n 2) 371

research, growth outflows, and profit instability are accompanied with smaller less autonomous boards however; larger companies have more autonomous boards. They declare larger board more independent than those of smaller board; and less independent board is expected to be incompetent and inefficient in executing its monitoring duties. Therefore, the outcomes of this study reject the view that smaller boards are always better.

Likewise, empirical tests uphold the widespread opinion that larger and autonomous boards are better and more effective.⁶³ The argument is posed that certain groups of companies get advantage from large boards having more insider demonstration, specifically; the companies which are diverse through industries having extraordinary influence are expected to have higher needs of advising.⁶⁴ Therefore, these companies are prospective to be benefited from larger board predominantly from external directors having appropriate knowledge and experience. The results of these empirical studies are consistent with these arguments.

Firstly, larger boards are expected to be diverse in experience, business contacts and skills as compared to smaller boards, protect companies' resources.⁶⁵ Similarly, larger boards decreases uncertainties and aids to secure critical resources, for example, contracts, finance and raw materials because of having more access to the external atmosphere of company.⁶⁶

Secondly, larger boards enhance managerial skills to make better and important decisions due to the heightened knowledge base on which business advice can be sought.⁶⁷ Finally, a corporate board's controlling capability is established to be

⁶³ Coles *et al.*, 'Boards: Does One Size Fit All' (2008) 87(2) *Journal of Financial economics* 329

⁶⁴ Renee Adams and Hamid Mehran, 'Corporate Governance, Board Structure and its Determinants in the Banking Industry' (2005) Working Paper Federal Reserve Bank of New York <<http://papers.ssrn.com/so13/papers.sfm>> accessed 20-02-2015

⁶⁵ Roszaini Haniffa and Muhammad Hudaib, 'Corporate Governance Structures and Performance of Malaysian Listed Companies' (2006) 33(7) *Journal of Business, Finance and Accounting* 1038

⁶⁶ John Pearce and Shaker Zahra, 'Board Composition from a Strategic Contingency Perspective' (1992) 29 *Journal of Management Studies* 411

⁶⁷ *Ibid* (n 61) 79

certainly connected with the size of board.⁶⁸ This is because a larger number of people with diverse knowledge will handle managerial decisions with higher consideration and monitoring.⁶⁹ This can help balance the power of otherwise a dominant CEO.

6.3.2 The Empirical Evidence on the Association between the Size of BODs and their Outcome

Empirically, the confirmation relating to the connection between board size and company performance is conflicting. Yermac⁷⁰ is one of the first to investigate the association between board size and performance of a company. He investigated this in a sample of 452 big US business organisations between 1984 and 1991. He reports an adverse liaison between corporate board size and performance.⁷¹ He demonstrates that his confirmation is robust to companies' particular qualities like size, development probability, board structure, director possession and industry. Particularly, his results show that shareholders' assessment of companies' declines steadily over a scope of board sizes between four and ten. Beyond a board size of ten, he finds no connection between board size and market assessment.

Likewise, US evidence⁷² and non-US evidence⁷³ suggested that, on average, smaller boards tend to perform better than larger ones. This work was criticised for focusing purely on large companies, therefore, its outcomes cannot be referred

⁶⁸ John and Senbet (n 2) 385

⁶⁹ Geoffrey Kiel and Gavin Nicholson, 'Board Composition and Corporate Performance: How the Austrian Experience Informs Contrasting Theories of Corporate Governance' (2003) 11(3) *Corporate Governance: An International Review* 194

⁷⁰ Ibid (n 6)

⁷¹ Ibid (n 6)

⁷² Nikos Vefas, 'Board Meeting Frequency and Firm Performance' (1999a) 53 *Journal of Financial economics* 113; Nikos Vefas, 'The Nature of Board Nomination Committees and their Role in Corporate Governance' (1999b) 26(1) *Journal of Business, Finance and Accounting* 199; Shijun Cheng, 'Board Size and the Variability of Corporate Performance' (2008) 87(1) *Journal of Financial economics* 157; Cheng *et al.*, 'Board Size and Firm Performance: Moderating Effects of the Market for Corporate Control' (2008) 31 *Review of Quantitative Finance and Accounting* 121;

⁷³ Eisenberg *et al.*, 'Larger Board Size and Decreasing Firm Value in Small Firms' (1998) 48(1) *Journal of Financial Economics* 35; Richard Bozec, 'Boards of Directors, Market Discipline and Firm Performance' (2005) 32(9) *Journal of Business, Finance and Accounting* 1921; Paul Guest, 'The Impact of Board Size on Firm Performance: Evidence from the UK' (2009) 15(4) *The European Journal of Finance* 385

and applied to smaller companies working in diverse legal and social settings.⁷⁴ However, another work examined the association between board size and performance in a sample of 879 small and medium size Finnish companies from 1992 to 1994; and described an adverse correlation between companies' performance.⁷⁵

Moreover, a negative relationship was also found between the performance of top-management and board size in a sample of 460 UK listed companies from 1988 to 1996.⁷⁶ Likewise, utilising a big sample of 2,746 UK listed companies from 1981 to 2002, a statistically negative and substantial affiliation was reported between board size and their outcome.⁷⁷ The outcomes of these studies normally provide empirical backing to the theory that smaller boards are more expected to have honest assessment of performance of top-management; actual monitoring and quicker decision-making.

Lastly, a negative relationship has also been reported between board size and corporate performance, in a sample of 347 Malaysian listed companies.⁷⁸ Therefore, the researcher submits that this also offers empirical support to the conclusions of prior studies that larger boards are not just alleged unproductive by shareholders; however additionally consume more managerial perquisites than smaller ones.

By contrast, a positive relation has also been identified⁷⁹ between board size and companies' performance, in a sample of 93 Nigerian listed companies from 1996 to 1999; larger boards decrease ambiguities and ensures to safeguard acute assets of company for example, raw materials, finance and contracts because of having higher access to the outside environment of company. This suggests that conflicts

⁷⁴ Ibid

⁷⁵ Eisenberg *et al.* (ibid 73) 37

⁷⁶ Dahya *et al.*, 'Outside Directors and Corporate Board Decisions' (2005) 11 Journal of Corporate finance 37

⁷⁷ Paul Guest (ibid 73) 387

⁷⁸ Ibid (n 72)

⁷⁹ Ibid (n 4)

occur between shareholders and companies regarding their insight of the relevance of larger boards.

Theoretically, bigger boards enrich awareness and skills to seek better advice, which enhances the ability of management to take better business decisions.⁸⁰ Similar evidence is also available for Australian, Swiss, and US listed companies, respectively.⁸¹ According to South African Companies Act 1973, all public companies should have at least two directors; however the JSE's Listings Rules require at least four directors from listed companies.

None of them sets a maximum number of the size of BODs. King II also does not provide the actual number of directors to constitute a board. However, it commences an overall norm that each board should reflect that its size makes it operative. This suggests that even though King II admits that a company's board size may probably affect its performance, it leaves the option of determining the actual board size for the companies themselves to decide. A plausible explanation for not prescribing a specific board number may be to avoid a tacit conclusion that it is likely to embrace a "one size fits all" method to corporate management.⁸²

For example, using a sample of 84 South African listed companies in 1998, no noteworthy link between the effectiveness of worth auxiliary to a company's intellectual and physical capital and board size has been reported.⁸³ Similarly, no significant link was documented among board size and frequencies of listing postponement by the JSE during examination of 81 South African listed companies from 1999 to 2005.⁸⁴ Therefore, it is suggested that board size may not be a vital driver of corporate performance in South African listed companies.

⁸⁰ Paul Guest (ibid 73) 387

⁸¹ Ibid (n 1, 2); Beiner *et al.*, 'An Integrated Framework of Corporate Governance and Firm Valuation' (2006) 12(2) European Financial Management 249

⁸² Ian MacNeil and Xiao Li, 'Comply or Explain: Market Discipline and Non-compliance with the Combined Code' (2006) 14(5) Corporate Governance: An International review 96

⁸³ Ho C-A and Williams SM, 'International Comparative Analysis of the Association Between Board Structure and the Efficiency of Value Added by a Firm from its Physical Capital and Intellectual Capital Resources' (2003) 38 The International Journal of Accounting 465

⁸⁴ Musa Mangena and Venancio Taurigana, 'Corporate Boards, Ownership Structure and Firm Performance in an Environment of Economic and Political Instability: The Case of Zimbabwe

The UK's CCG 2014 also does not stipulate the actual count of directors that should constitute a board. However, it proposes that: the size of board should not be as large to be cumbersome rather it should be reasonable to fulfil the necessities of business; and if the composition of board needs to be changed it could be altered without unnecessary disturbance.⁸⁵

The CCG of Pakistan does not provide any specific number for BODs. However the common practice in listed companies of Pakistan shows the number of BODs ranging from 7 to 11, the most common number is from 9 to 10. For example, the Pakistan Petroleum Limited (PPL)⁸⁶ has 9 members on its BODs; Nestle⁸⁷ has 9, PIA has 11,⁸⁸ Akzo Nobel⁸⁹ has 7, Linde⁹⁰ Pakistan has 9, Shell⁹¹ has 10, Pak Refinery Limited (PRL)⁹² has 10. The unfortunate and interesting thing, the researcher noticed relating to the BODs of these companies is that there is no female director in any of these companies' BODs.

The researcher argues that the size of BODs has an impact on the corporate and financial performance of companies as evidenced by above studies. However, the question whether larger boards have a positive impact or smaller boards have a positive impact is difficult to answer; because in this case first there is need to define a particular number that what number denotes smaller boards and what number denotes larger boards.

Therefore, this thesis argues that the size of corporate boards should be according to the size and nature of business of a company. Neither it should be too small that it would become difficult for a company to carry out business and nor it should be too large that it would become rather burden in terms of cost. Therefore, the basic

Stock Exchange Listed Companies' (2006) Working Paper School of management Bradford University UK

⁸⁵ Brammer *et al.*, 'Gender and Ethnic Diversity Among UK Corporate Boards' (2007) 15(2) Corporate Governance: An International Review 393

⁸⁶ www.ppl.com.pk

⁸⁷ www.nestle.pk

⁸⁸ www.piac.com.pk

⁸⁹ www.akzonobel.com.pk

⁹⁰ www.linde.pk

⁹¹ www.shell.com.pk

⁹² www.prl.com.pk

idea at the time of constituting a corporate board should be to bring together best talent, range of skills, experience and different backgrounds so that the honest evaluation of managerial performance, effective managerial monitoring, high quality strategies, better handling of risks and faster decision-making could be achieved by that board.

6.4 Board Composition

6.4.1 The Theoretical Link between the Proportion of Board Composition and Corporate Performance

Board composition means the number of NEDs as compared to executive directors on board. In this section, NEDs refer to the percentage of the number of NEDs to the total number of directors of a company and stated as a proportion. This section presents the two contrasting views with regards to number of NEDs on boards: those who support majority of NEDs and; those who support majority of executive directors on corporate boards; then presents this researcher's analysis and conclusion that which view is better and could be better for the listed companies of Pakistan.

The NEDs are external directors who supervise the decisions and policies of executive directors. Those who are advocates of more NEDs (outsiders) on the board normally argue by relying on agency, resource independence, information asymmetry and signalling theories. On the other hand, those who support more executive directors (insiders) on the board make their arguments on the basis of stewardship theory.

The agency theory argues that, boards controlled by more executive directors are usually not responsible enough.⁹³ Conversely, NEDs being independent are more likely to help in making independent decisions in board.⁹⁴ They fulfil their monitoring duties efficiently and effectively and benefit the company assets in terms of expertise, experience, reputation and business contacts in order to

⁹³ Eugene Fama (ibid 1); Sonnenfeld (n 53) 108

⁹⁴ Cadbury Committee, *Report of the Committee on the Financial Aspects of Corporate Governance* (London: Gee and Company 1992)

maintain their position and due to the presence of competitive business markets existed in and outside the company.⁹⁵

Another argument in favour of more NEDs is that, if upper internal management of a company gets control of the corporate board, the chances of expropriating the shareholders' wealth increases because in such environment top management is more likely to hatch and conspire among them. Moreover, it also reduces healthy competition among managers for improved performance.⁹⁶

However, NEDs has the potential to handle and lessen this conspiracy because of having motivations to ripen and maintain their reputations as experts in controlling board's decisions.⁹⁷ It reduces the probability of internal managerial involvement. Similarly, by the addition of NEDs the capability of board can be enhanced as a market encouraged framework by less expensive relocation of control.⁹⁸ Their independence helps NEDs to avoid politeness and courtesy at the expense of truth, frankness, and constructive criticisms of executive management in the boardroom without fear of victimisation.

Moreover, the appointment of independent NEDs assists in decreasing information asymmetry by signalling the aim of executive directors reliably in order to deal with external potential investors equitably and consequently, to protect their investment.⁹⁹ It also gives message to the market insiders' intent to trust on decision experts and their gratitude of the significance of untying the controlling functions and decision-making.¹⁰⁰ Therefore, proponents of this view believe that a higher percentage of NEDs on corporate boards will improve corporate performance.

However, proponents of stewardship theory advocate the view that corporate boards having more NEDs might have negative effect on companies'

⁹⁵ Ibid (n 60)

⁹⁶ Ibid (n 31) 147

⁹⁷ Ibid (n 73)

⁹⁸ Ibid (n 73); Michael Jensen (ibid 5)

⁹⁹ Black *et al.*, 'Does Corporate Governance Predict Firm's Market Values? Event Study Evidence From India' (2006a) 4(4) Journal of Law, Economics and Organisation 366

¹⁰⁰ Fama and Jensen (n 29) 315

performance.¹⁰¹ They argue that NEDs do not have enough knowledge regarding business therefore; they cannot understand the complex matters of company because they act as directors occasionally as part-timers and also act as directors of other companies' boards;¹⁰² they cannot give enough time required to deal with their advisory and monitoring responsibilities. The researcher submits that this argument does not apply only on NEDs even executive directors hold positions of directors in more than one company. Therefore regarding these issues both executive and NEDs are on equal footing.

However, managers are principally reliable persons and are good wardens of the assets assigned to them.¹⁰³ In addition to this, executive directors spend their entire working lives in the company they manage; therefore they preferably comprehend the businesses in contrast to external NEDs and can take greater decisions for company.¹⁰⁴ They believe that higher corporate performance is attached to the majority of internal directors because they certainly work to raise the profit of their shareholders.

In view of this, decisions of a corporate board having large number of NEDs would be of inferior quality, which would lead to low performance of a company. The researcher negates this argument and submits that, not all executives always think about the higher corporate performance of a company, rather in the absence of an independent monitoring eye the chances of expropriation of shareholders' wealth increase.

Another argument in favour of executive directors is that, corporate boards having large number of external directors are more incline to suppress strategic actions and

¹⁰¹ Baysinger BD and Hookisson RE, 'The Composition of Board of Directors: Performance Effects of Changes in Board Composition' (1990) 1 Journal of Law, Economics and Organisation 74; Charlie Weir and David Laing, 'The Performance-Governance Relationship: The Effects of Cadbury Compliance on UK Quoted Companies' (2000) 4 Journal of Management Governance 267

¹⁰² Jiraporn *et al.*, 'Ineffective Corporate Governance: Director Busyness and Board Committee Membership' (2009) 33 Journal of Banking and Finance 819

¹⁰³ Gavin Nicholson and Kiel Geoffrey, 'Can Directors Impact Performance? A Case-based Test of Three Theories of Corporate Governance' (2003) 15(4) Corporate Governance-An International Review 588

¹⁰⁴ Ibid

managerial initiative, which occur due to extreme supervision and lack of business knowledge.¹⁰⁵ On the other hand, large number of executive directorship is related to great access to information, which ultimately results into high level decision-making. This can have a positive effect on corporate performance. In fact, external directors do not generally have such access to informal sources of information and knowledge in company which internal directors have. Consequently, decisions of a board controlled by NEDs would not be of higher excellence which would prompt low performance of a company.

6.4.2 The Empirical Evidence on the Impact of NEDs on Companies' Performance

The existing literature on the impact of large number of NEDs and company performance is contradictory. A few disclosure studies¹⁰⁶ have presented significant association between the percentage of NEDs and intensities of deliberate disclosure to disclose financial information, due to the positive impact on the decisions of managers by NEDs.

It has also been reported that the addition of NEDs on corporate boards proliferate a companies' compliance with disclosure requirements which leads to more widespread financial disclosure, and provide investors more precise position of a company; therefore due to the existence of NEDs on corporate boards the CG values improve considerably.

A number of studies on CG have also established a positive connection between the percentage of NEDs and foreign share ownership on a board. The reason is that foreign investors consider NEDs more active and operative in controlling

¹⁰⁵ Haniffa and Hudaib (n 65) 1039

¹⁰⁶ Charles Chen and Bikki Jaggi, 'Association Between Independent Non-executive Directors, Family Control and Financial Disclosures in Hong Kong' (2000) 19(4) *Journal of Accounting and Public Policy* 285; Ros Haniffa and Terry Cooke, 'Culture, Corporate Governance and Disclosure in Malaysian Corporations' (2002) 38 (3) *Abacus* 317

unscrupulous conduct of managers, and hence safeguarding the interests of shareholders.¹⁰⁷

In terms of compliance, external directors may affect the observance of CG principles due to their autonomous decision and to defend their reputation as directors. They can also have impact on the compliance of CG best practices in order to improve their employability in efficient and competitive business markets.¹⁰⁸

6.4.2.1 Appointment of INEDs

After the occurrence of serious corporate disasters and loss around the world in the last couple of decades, progressive rounds of CG change have looked to enhance the CG of companies.¹⁰⁹ The appointment criteria for INEDs have been identified as a basic component responsible for corporate disaster. Rules and regulations have been formulated in order to make the procedure more formal, thorough and to take advantage of a more expert group of people who are more illustrative of society.¹¹⁰

The current number of directors is depicted as a little, identical group who are demographically identical and through a misty procedure of appointment self-replicate.¹¹¹ In spite of many years of change, the Walker Review¹¹² completed in the wake of the 2008 financial crisis established that poor CG was the major cause of failures and that the appointment mechanisms for NEDs had been not changed.

¹⁰⁷ Musa Mangena and Venancio Taurigana, 'Disclosure, Corporate Governance and Foreign Share Ownership on the Zimbabwe Stock Exchange' (2007) 18(2) *Journal of International Financial Management and Accounting* 75

¹⁰⁸ *Ibid* (n 73)

¹⁰⁹ Mary Gaughan, 'A Conceptual Framework for Reputational Capital Development: An Exploratory Study of First-Time FTSE 100 NED Appointees' (PhD Thesis, Cranfield University 2013)

¹¹⁰ *Ibid*

¹¹¹ Cleopas Sanangura, 'Behind the Boardroom Door: The Effectiveness of Board of Directors in Creating Shareholder Value and the Effect of Shareholder Activism in Financial Service Sector in Emerging Markets; Corporate Governance in South Africa and Zimbabwe' (PhD thesis, Nottingham Business School 2006)

¹¹² Walker Review, 'A Review of Corporate Governance in UK Banks and Other Financial Industry Entities' (HM Treasury: London UK 2009) <http://www.hm-treasury.gov.uk/walkerreview_information.htm> accessed 10 May 2015

The literature relating to the appointment mechanism endorses that it is a defective mechanism, occurring via referrals and the links of Chairmen. Though, the literature does not examine the appointment mechanism at individual level. The previous studies conducted to investigate the appointment procedures of NEDs are mostly quantitative by utilising secondary data, which do not uncover the truth about appointment process. Therefore, a qualitative study is required regarding the examination about appointment process of a NED, in order to expand understanding about the procedures included.¹¹³

6.4.2.2 Percentage of NEDs and Corporate Performance

Some empirical studies evidenced that boards dominated by NEDs deliver higher performance.¹¹⁴ In a study conducted utilising a sample of 311 UK listed companies from 1994 to 1996; a positive relationship was reported between the performance of corporations and the proportion of NEDs.¹¹⁵ Moreover, an investigation was held of a US sample of 744 autonomous NEDs' resignations from 1990 to 2003 to determine the worth that market resides on the impartiality of board.¹¹⁶ And it was found that the declaration of impartial NEDs resignations result in 1.22% loss in a company's market value. This shows that the independence of board is highly valued by investors because impartial boards are linked with higher monitoring of managerial conduct.

Similarly, a momentous and positive relationship was identified between the proportion of external directors and the corporal and intellectual capital performance of a company in 84 South African listed companies in 1998.¹¹⁷ Likewise, an adverse relationship was reported between the percentage of NEDs and the occurrences of company interruptions from the JSE in a sample of 81

¹¹³ Andrew Pettigrew, 'The Character and Significance of Strategy Process Research' (1992) 13(2) Strategic Management Journal 5

¹¹⁴ Weir *et al.*, 'Internal and External Governance Mechanisms: Their Impact on the Performance of Large UK Public Companies' (2002) 29(5) Journal of Business, Finance and Accounting 579

¹¹⁵ Ibid

¹¹⁶ Manu Gupta and Paige Fields, 'Board Independence and Corporate Governance: Evidence From Director Resignations' (2009) 36(1) Journal of Business, Finance and Accounting 161

¹¹⁷ Ibid (n 73)

companies from 1999 to 2005.¹¹⁸ This submits that South African registered companies which have greater proportion of NEDs are not usually expected to be deferred from the stock exchange. However, evidence is also available, which is entirely consistent with prior research that boards having large number of NEDs perform better for a sample of Tunisian and Zimbabwean listed companies, correspondingly.¹¹⁹

However, some other studies found an adverse association of the percentage of NEDs with performance.¹²⁰ In a sample of 25 Canadian companies from 1976 to 2005, an adverse connexion was established between the proportion of NEDs and performance. Likewise, Nigerian companies with less NEDs performed better than those with more NEDs were found.¹²¹ This advocates that if NEDs bring objectivity, independence and experience to have impact upon the decisions of board, they may also throttle managerial initiative via extreme monitoring. A third view is that the existence of NEDs does not have influence on performance.¹²² Such as, no link was found between board composition and performance for a sample of 142 US listed companies.¹²³

The King II and the JSE Listing Rules assert that the number of NEDs should be greater impartial from management for the purpose of protecting the interest of investors. This proposes that the King Code anticipates companies that employ

¹¹⁸ Musa Mangena and Eddie Chamisa, 'Corporate Governance and Incidences of Listings Suspension by the JSE Securities Exchange of South Africa' (2008) 43 *The International Journal of Accounting* 28

¹¹⁹ El Mehdi, 'Empirical Evidence on Corporate Governance and Corporate Performance in Tunisia' (2007) 15(6) *An International Review* 1429

¹²⁰ Anup Agrawal and Charles Knoeber, 'Firm Performance and Mechanism to Control Agency problems between Managers and Shareholders' (1996) 31 *Journal of Financial and Quantitative Analysis* 377; David Laing and Charlie Weir, 'Governance Structures, Size and Corporate Performance in UK Firms' (1999) 37(5) *Management Decisions* 457; *Ibid* (n 65)

¹²¹ Sanda *et al.*, 'Corporate Governance Mechanisms and Firm financial Performance in Nigeria' (2005) AERC Research Paper 149, Nairobi Kenya
<<http://opendocs.ids.ac.uk/opendocs/bitstream/handle/123456789/2258/RP%20149.pdf?sequence=1>> accessed 20 April 2015

¹²² Vefas N and Theodorou E, 'The Relationship between Board Structure and Firm Performance in the UK' (1998) 30 *British Accounting Review* 383; Charlie Weir and David Laing, 'The Performance-Governance Relationship: The Effects of Cadbury Compliance on UK Quoted Companies' (2000) 4 *Journal of Management and Governance* 265

¹²³ Benjamin Hermalin and Michael Weisbach, 'The Effects of Board Composition and Direct Incentives on Firm Performance' (1991) 21(4) *Financial Management* 101

large number of NEDs have better CG practices as compared to those that employ less NEDs. Nevertheless, there have been a chain of corporate scams in South Africa in the past due to weak boards that failed to supervise the business affairs effectively and failed to ensure the engagement of senior officers in self-dealing e.g. Regal Treasury Bank.¹²⁴

Section 269A of the South African Companies Act 1973 entails the appointment of a minimum of two INEDs from every public company. King II and the JSE Listings Rules also necessitate South African listed companies to appoint majority of NEDs in their corporate boards. King II additionally necessitates that the large number of NEDs should be autonomous in order to make sure that the interests of minority shareholders are safeguarded satisfactorily. This shows that King II believes that companies whose boards are dominated by NEDs perform financially better as compared to those with less number of NEDs.

Moreover, King III also postulates that corporate boards should maintain an equilibrium of executive and NEDs, but with a large number of NEDs. In addition, the board should certify an appropriate equilibrium of power on the board. There should not be any individual or group of individuals that could dominate the decisions of board. King III moves a step further and suggests that an independent non-executive chairman¹²⁵ should monitor the board, who can deliver the required direction for an effective board. The condition is being an independent and this should be part of his annual evaluation.

6.4.2.3 The NEDs within the UK Governance Context

Corporate scandals such as Equitable Life, Maxwell Corporation and Polly Peck prompt comprehension regarding loss of confidence in auditors¹²⁶ and director

¹²⁴ Janis Sarra, 'Strengthening Domestic Corporate Activity in Global Capital Markets: A Canadian Perspective on South Africa's Corporate Governance' (2004) Working Paper No. 118, The George Washington University Law School <<http://www.ssrn.com/abstract=628702>> accessed 20-02-2015

¹²⁵ Not be the CEO of the company

¹²⁶ Nigel Macdonald and Aileen Beattie, 'The Corporate Governance Jigsaw' (1993) 23 Accounting and Business Research 304

remuneration.¹²⁷ The Cadbury Committee (1992) was established to analyse economic statement and accountability mechanisms. The chief proposals as provided in the Code of Best Practice were to: enhance the number and influence of INEDs; distinguish the responsibilities of CEO and Chairman and; establish sub-committees, involving a nominations committee, to monitor the hiring procedure for directors.¹²⁸

The Greenbury Report (1995) was a reaction to apprehensions regarding directors' pay.¹²⁹ It was trailed by the Hampel Report (1998) which increased the part of NEDs further in conveying CG standards. This report suggested that minimum of one third of each board ought to be INEDs, and that committees involving nominations committee ought to be made to a great extent out of INEDs.¹³⁰

In 2002, Derek Higgs was named by the UK Government to review the part and viability of NEDs in encouraging accountability and the performance of company.¹³¹ This prompted a revised Combined Code (2003)¹³² consolidating some of Higgs' proposals. This Combined Code incorporated and accompanying the suggestions regarding the appointment of NEDs presented below:

- 1) Board composition to consist of fifty per cent NEDs;
- 2) Proper and transparent techniques to be used for directors' hiring;
- 3) Summary rules were accommodated for the accountabilities of the nominations committee

Taking after these changes, the number of executive directors was reduced and the number of NEDs on BODs expanded. The aggregate number of FTSE 100

¹²⁷ Kevin Keasey and Mike Wright, 'Issues in Corporate Accountability and Governance: An Editorial' (1993) 23 Accounting and Business Research 291

¹²⁸ Cadbury Sir Adrian, *Report of the Committee on the Financial Aspects of Corporate Governance* (Gee and Co. Ltd. London 1992)

¹²⁹ Greenbury Sir Richard, *Directors' Remuneration* (Gee and Co. Ltd. London 1995)

¹³⁰ Hampel sir Ronie, *Committee on Corporate Governance: Financial Report* (Gee and Co. Ltd. London 1998)

¹³¹ Derek Higgs, *Review of the Role and Effectiveness of Non-Executive Directors* (DTI London 2003)

¹³² Combined Code, *Combined Code, Principles of Corporate Governance* (Gee and Co. Ltd. London 2003)

directors remained 1116 in 2008, with 353 executive directors and 763 NEDs. This was the most elevated number of NEDs ever recorded.

In 2008, after severe damage and disaster in the banking sector, a review of CG was established and this review uncovered the continued shortcomings in the governance of FTSE 100 companies. In spite of many years of changes and proposals little had changed in the appointment mechanism, the corporate directors remain a homogeneous group of people.¹³³

6.4.2.4 Board Composition within Pakistan's Governance Context

The above mentioned studies present differing opinions regarding the impact of more NEDs on corporate board and companies' performance metrics. However, these studies have consensus upon one point namely, that appointment of NEDs increase boards' independence and improve monitoring. That's why the UK's corporate boards are required to have number of NEDs larger than executive directors;¹³⁴ however South African corporate boards are required to have fifty per-cent NEDs.¹³⁵ However, the CCG¹³⁶ of Pakistan requires the appointment of only one INED obligatory for companies and prefer one third of the corporate board to have INEDs, which is very less.

Fundamentally, the board is responsible to ensure the achievement of a company by guiding and monitoring the affairs of company collectively; protecting the interests of its shareholders and significantly related stakeholders while considering the law, relevant regulations and commercial concerns. The Pakistan's CCG requires from each listed company to appoint INEDs a minimum of one and preferably one third of the aggregate of the board (as mentioned above).

The meaning of the word independent denotes that a person acting as director does not have any other link or affiliation, with the listed company, its associated

¹³³ Ibid (n 126)

¹³⁴ As mentioned in previous section 6.4.2.3

¹³⁵ It is mentioned in section 6.4.2.2

¹³⁶ Clause (i) (b) of the CCG 2012

companies, subsidiaries, holding company or director whether pecuniary or otherwise.¹³⁷ The criteria of impartiality are very strict according to the CCG which is inevitable for the companies working in an environment where most of the business is family and state owned.¹³⁸

However, the researcher submits that the number of NEDs should be increased in the listed companies of Pakistan to decrease the manipulation of power in the family owned companies, SOEs and political influences.¹³⁹ The number of INEDs in Pakistani listed companies should be at least fifty per-cent, so that the decisions of the board and interests of shareholders could be properly monitored. Holistic efforts are needed for this, as the number of available NEDs is not enough for demand and, if NEDs are available they are not willing to work as in companies because of less remuneration packages.

The researcher further submits that the Regulators should take effective measures to offer attractive remuneration packages to hire independent NEDs and also take steps for the proper qualification and trainings of NEDs so that the demand could be met.

Secondly, another important issue in this respect is to create awareness among business community regarding the role and position of NEDs. Generally, the mind-set in Pakistan's business community is that the office of NEDs is an honorary office and they should not have to say more about companies' policies neither it is important for them to attend all meetings of the board. This trend is more common among private, small and new companies due to the lack of knowledge and qualification.

The PICG and SECP should take measures to educate the business community that the role of NEDs is as important as of executive directors, and it should be compulsory for NEDs to attend all meetings of the BODs. Their independence

¹³⁷ Clause (i) (b) of the CCG 2012 of Pakistan.

¹³⁸ As discussed in chapter one, four and five.

¹³⁹ The evidence of power manipulation and political influences in SOEs and FOEs is provided in section 1.2.1.

does not mean that they have no relation with company matters and have no knowledge about the company business; instead independence denotes that they can monitor the policies, decision-making and risk management of BODs independently, and during their presence executive managers become cautious about actions.

A corporate board balanced with executive and NEDs can better protect the wealth of shareholders from expropriation and also helps to improve CG practices in company. The researcher further submits that, the awareness regarding the role of INEDs is also necessary to curtail the practice according to which family owned companies appoint their family members or major children as NEDs just to fulfil a requirement.

Moreover, the CCG of Pakistan requires that,¹⁴⁰ an individual can hold the directorship of seven companies at a time: however this restriction excludes of holding the directorships in the listed subsidiaries of a listed holding company. According to first part of this provision a person can be a director of seven companies at the same time and; according to second part there are no limits of number of listed holding companies for which a person can be director. The researcher's view is that this provision must be amended, as a person being director of so many companies cannot do justice with any one of them. Rather, he will be biased and take and/or promote decisions of company based on his personal bias and interests rather keeping the company's and shareholder's stakes on higher grounds.

This practice can be minimised in two ways: one the number of directorships a person can hold at any one time ought to be reduced and restricted in respect of all companies including, subsidiary and holding companies. Secondly IIs can also play a positive part in this respect by keeping an eye on the working and decisions of such directors.¹⁴¹

¹⁴⁰ Clause (ii) of the CCG 2012

¹⁴¹ The role of institutional investors in this respect is discussed in detail in chapter seven.

6.5 Role and Responsibilities of BODs

The board is the central point of the CG mechanism in the company and a principal connection between company and stakeholders. The board's supreme duty is to ensure the better performance of company in generating value for its shareholders.¹⁴² The researcher submits that, by performing its responsibilities properly with care, honesty and in favour of the company and shareholders, the board cannot only boost the performance of a company but also promote the CG norms and set standards for other companies to follow as well.

It is the primary responsibility of directors to monitor the administration and performance of a company. They direct and control company for the sake of investors and their roles and responsibilities are enclosed in the statute. BODs are recognised as being responsible for a multitude of specific and general tasks, which include: advising and monitoring management; defending and guaranteeing the reliability of the audit; paying administration and the BODs itself; the hiring of new management and other board members, and finally; the success of the company.

In short, the functions of board are to direct, advice, manage and monitor company affairs. These tasks rest on the shoulders of NEDs as internal directors usually had clashes of interest that could damage the interests of shareholders and stakeholders.

The researcher submits that, such practices are essential for the CG structure of Pakistan, where companies are run by directors for their own benefits or for the welfares of major shareholders who are families and SOEs. Resultantly, the stakes of minority shareholders remained unprotected. This problem can be resolved by two ways: one by making amendments in the CCG and introducing provisions which clearly define the roles of BODs and there should be left no room for some

¹⁴² IOD, Draft Code of Governance Principles for South Africa – 2009 King Committee on Governance' 21 <www.iodsa.co.za> accessed 20-02-2015

groups to spoil the interests of weaker; secondly, IIs can play a positive part by monitoring the activities of directors and by raising their voice in AGMs.¹⁴³

The CG literature recommends several theories regarding BODs and the form of their involvement. Stiles and Taylor (2001)¹⁴⁴ provide a summary of five diverse theoretical viewpoints:

- 1) Agency theory, suggests that, the responsibility of BODs is to administer the management actions as a consequence of the parting of ownership from control, because managers might perform for their own benefits instead of the shareholders.
- 2) Stewardship theory advocates that the stakes of managers' and company are associated with each other. Therefore the quest for benefits and shareholder importance will ponder absolutely on the individual manager and the governance framework. The role of BODs is to assist and encourage.
- 3) Resource Dependency theory places that the BODs connects the company to the outer atmosphere in order to guarantee assets and to safeguard its own interests.
- 4) Class Hegemony asserts that companies are the agents of people and the part of BODs underlines the selection of correct persons regarding social position and impact.
- 5) Managerial Hegemony proposes that operating a company is anticipated by CG and administration.

These theories provide a diverse point of view.¹⁴⁵ The literature regarding CG and the BODs has been ruled by the conventions of Agency Theory. Additionally, it has been suggested that BODs should be generally active and its members should

¹⁴³ Role of institutional investors in detail is discussed in chapter 7.

¹⁴⁴ Philip Stiles and Bernard Taylor, *Boards at Work: How Directors View their Roles and Responsibilities* (Oxford University Press 2001) "See generally"; Collins Ntim, 'Internal Corporate Governance Structures and Firm Financial Performance: Evidence From South African Listed Firms' (PhD Thesis, University of Glasgow 2009)

¹⁴⁵ Tebogo Magang, 'Culture and Corporate Governance in South Africa' (PhD Thesis, University of Bradford 2012); *ibid* (n 144)

participate in decision making. However, little has been done to measure practically the participation of directors on the decision making process.¹⁴⁶

6.5.1 Board Working Through Management

Boards can confer their powers to management in two ways: where the executive directors taking the important decisions, and the management’s involvement remains minimal; or the executive directors require top management to contribute in making major decisions regarding the governance of companies. Following diagram shows the procedure of board working through management.

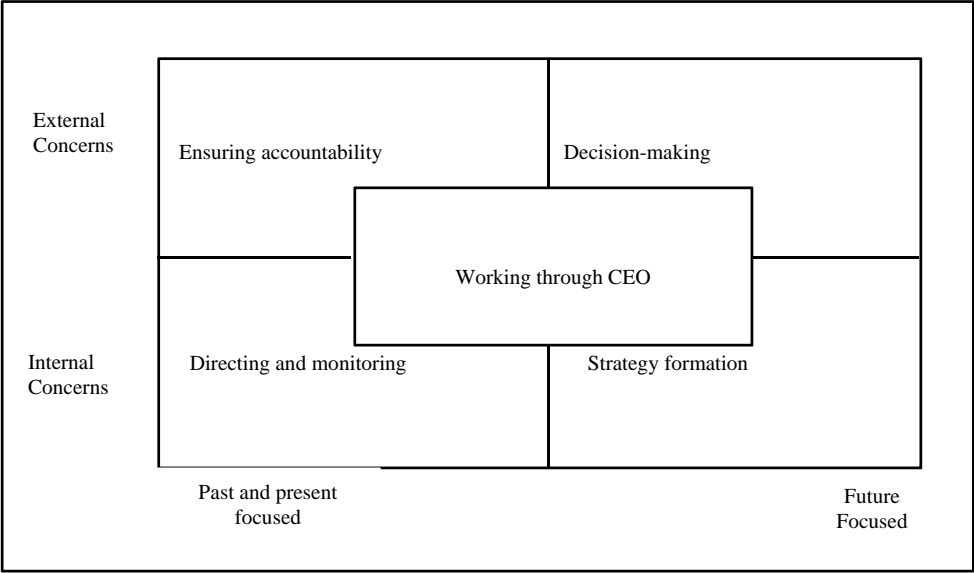


Figure: 6.2: Board Functions Working Through Management¹⁴⁷

6.5.2 Role of NEDs

The previous studies suggest three key roles of NEDs:

¹⁴⁶ Roberts *et al.*, ‘Beyond Agency Conceptions of the Work of the Non-executive Director: Creating Accountability in the Board-room’ (2005) 16(1) British Journal of Management 5

¹⁴⁷ Adapted from Bob Tricker

- 1) Monitoring, when NEDs monitor the activities of executive directors with the purpose of securing shareholders' interests;¹⁴⁸
- 2) Strategy development, when NEDs take part in strategy formation and the distribution of assets and;¹⁴⁹
- 3) Conflict resolution, when NEDs are involved in setting out to board payment, procedures and the appointment and dismissal of board members.¹⁵⁰

These responsibilities of NEDs are sustained by a qualitative study of senior decision makers.¹⁵¹ However, the part of NEDs in listed companies concentrated more on monitoring and resolving clashing between parties.¹⁵² There was less focus on strategy growth. Similarly, another study evidenced NEDs' participation in policy making for enhancing the skills and inspiration of the individual NEDs to deal with special conditions, for example emergency circumstances.¹⁵³ In this more behavioural description of the role, the possibly inconsistent strains of performing essential in the NEDs' part have also been acknowledged.¹⁵⁴

However, the focus was on the significance of companies deliberately choosing what is anticipated from their NEDs, by looking at the necessities of the business and the desires of its investors. Evidence was also found showing the dissimilarities regarding the perception how investors and chairmen saw the NEDs part and promote moving beyond a 'one size fits all' depiction of the role. Some studies¹⁵⁵ also designate the following roles of NEDs:

- An auditor role, when the environment is extremely synchronised;

¹⁴⁸ Charlie Weir and David Laing, 'Governance Structures, Director Independence and Corporate Performance in the UK' (2001) 13(2) *European Business Review* 86

¹⁴⁹ Bob Tricker, *Corporate Governance* (Oxford University Press 1984) "See generally"

¹⁵⁰ Terry McNulty and Andrew Pettigrew, 'The Contribution, Power and Influence of Part-time Board Members' (1996) 4(3) *Corporate Governance-An International Review* 160

¹⁵¹ Dixon *et al.*, 'An Investigation into the Role, Effectiveness and Future of Non-executive Directors' (2005) 31(1) *Journal of General Management* 1

¹⁵² Long *et al.*, 'The Role of the Non-executive Director: Findings of an Empirical Investigation into the Differences between Listed and Unlisted UK Boards' (2005) 13(5) *Corporate Governance* 667

¹⁵³ Andrew Pettigrew and Terry McNulty, 'Power and Influence in and Around the Boardroom' (1995) 48(8) *Human Relations* 1

¹⁵⁴ Annie Pye and Gillian Camm, 'Non-executive Directors: Moving Beyond the 'One-Size-Fits-All' View' (2003) 28 *Journal of General Management* 52

¹⁵⁵ *Ibid*

- A consultant role, to guide on and assist policy making;
- A tame pensioner, when active part is hardly required, only for independent presence;
- A super NED, who meets the necessities relating to risk management and strategy development.

Although, this structure needs to develop additionally however it provides an analytical approach that would facilitate business community and regulators to elucidate their anticipations of the NEDs part and facilitate the NEDs appointment procedure. There is no agreement in the existing literature regarding the role of a NED. It differs on the basis of companies' background, expertise and incentives for individuals. This creates a challenge to nominations committees and the board for selecting a person as NED.

In short, it can be concluded that, the BODs has four main tasks to perform, which are to audit, coach, steer and supervise. These four tasks depend on four key factors that are; board perspective, board behaviour, internal circumstances and external circumstances. It is expected that the board will be an auditing tool if administration is operative and irrelevant external factors are involved; an instruction tool if administration is unproductive and for short-term, a steering tool if board is involved in executive tasks for long-term, and a monitoring tool if board plays monitoring tasks and external factors are considerable.

6.6 Board Structures

This section considers and compares the two main systems of board structures that are most common in industrialised countries. The aim to include this section in this chapter is to investigate which form of board could be better for Pakistan. Though Pakistan already has one-tier system and the researcher agrees that one-tier system is best suitable for Pakistan. However, a study¹⁵⁶ has suggested that two-tier system could be better for Pakistan.

¹⁵⁶ Syeda Shabbir, 'The Role of Institutional Shareholders Activism in the Corporate Governance of Pakistan' (2012) 1(2) Journal of Humanities and Social Sciences 1, 5

In terms of financial and corporate performance and board turnover of the largest companies listed on the stock exchanges, the one-tier and two-tier board systems are effective.¹⁵⁷ Therefore, it is not conceivable to consign superiority to either of them. In the Anglo-Saxon countries like the UK and the US, the one-tier board system governs companies. A one-tier board system consists of executive and NEDs. The responsibilities of management and control are united into a single body. Normally, the single board is monitored by itself.

In order to address this problem, independent outside directors were recognised and audit committees were introduced. A major disadvantage of the one-tier system is the power concentration of the CEO and the lack of feedback from other stakeholders. However, this disadvantage can be overcome by monitoring the acts of CEO through INEDs and IIs by giving them proper representation in the board. The diagram below presents the two different structures of BODs.

In two-tier-board system, the companies are administered by an executive management board and a supervisory board. In this system, executives exert a minimal influence on stock prices and shareholders, but a considerable influence of other stakeholders, who are highly dedicated to the company and are ready to contribute officially to the governance matters of the company. The advantage of this system is a clear 'checks and balance' approach; however the disadvantage can be a power struggle at the expense of the competitive edge of the company.

¹⁵⁷ Cleopas Sanangura, 'Behind the Board-room Door. The Effectiveness of Board of directors in Creating Shareholder Value and the effect of Shareholder Activism in Financial Service Sector in Emerging Markets: Corporate Governance in South Africa and Zimbabwe' (PhD thesis, The Nottingham Trent University 2006)

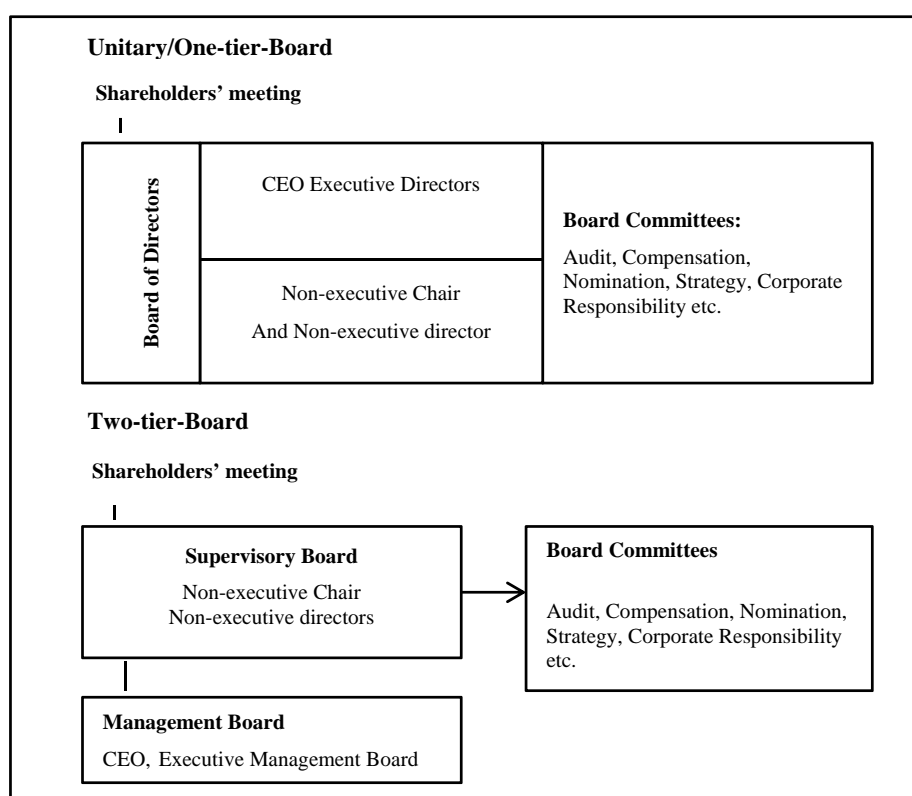


Figure 6.3: Types of Corporate Boards¹⁵⁸

The table below presents the strengths and weaknesses of both types of board systems.

Table 6.1: Merits and Demerits of One-Tier and Two-Tier Systems¹⁵⁹

Categories	Advantages and strengths	Disadvantages and weaknesses
One-tier-system	Restricted information asymmetry, Frequent meetings, Direct access to information	Responsibility of monitoring and strategy setting, Independence of NEDs
Two-tier-system	Separation of control and management, No conflict of interest, Independence of the members of the supervisory board	Co-determination (a structural weakness because of two organs of employee and shareholder representation), Limited involvement in strategic decision making, Information asymmetry

¹⁵⁸ According to Heidrick and Struggles (2009)

¹⁵⁹ According to Jungmann (2006)

Based on above discussion, the researcher submits that, one-tier-board system prevalent in Pakistan is completely suitable. The argument is that, the only aim of ‘supervisory board’ in two-tier system seems ‘check and balance’; which can be fulfilled (as discussed above) by enhancing the number of NEDs and giving the proper representation to IIs in the board and making them strong and active enough to monitor and challenge the activities of board members. However, introducing an entirely new two-tier system would not be suitable in terms of extra cost and time. The new system will take much time and money to settle and operate in a framework in which the whole business community is not aware with it.

6.7 Board Effectiveness Model

Board effectiveness combines various factors such as: the appointment process of the BODs, how fair is it; frequency of meetings of BODs, how often board meets and gives proper time to the company matters; the director development, whether the trainings are given regularly to directors to familiarise them with the new CCG, related laws and their responsibilities according to the changing corporate world; the assessment of BODs performance; management decisions and; execution and implementation of management strategy throughout the whole company.

This section examines these factors, their impact on the effectiveness on corporate boards and develops a ‘board effectiveness model’ for the listed companies of Pakistan. The following figure shows the model of board effectiveness for the listed companies of Pakistan developed by this researcher.

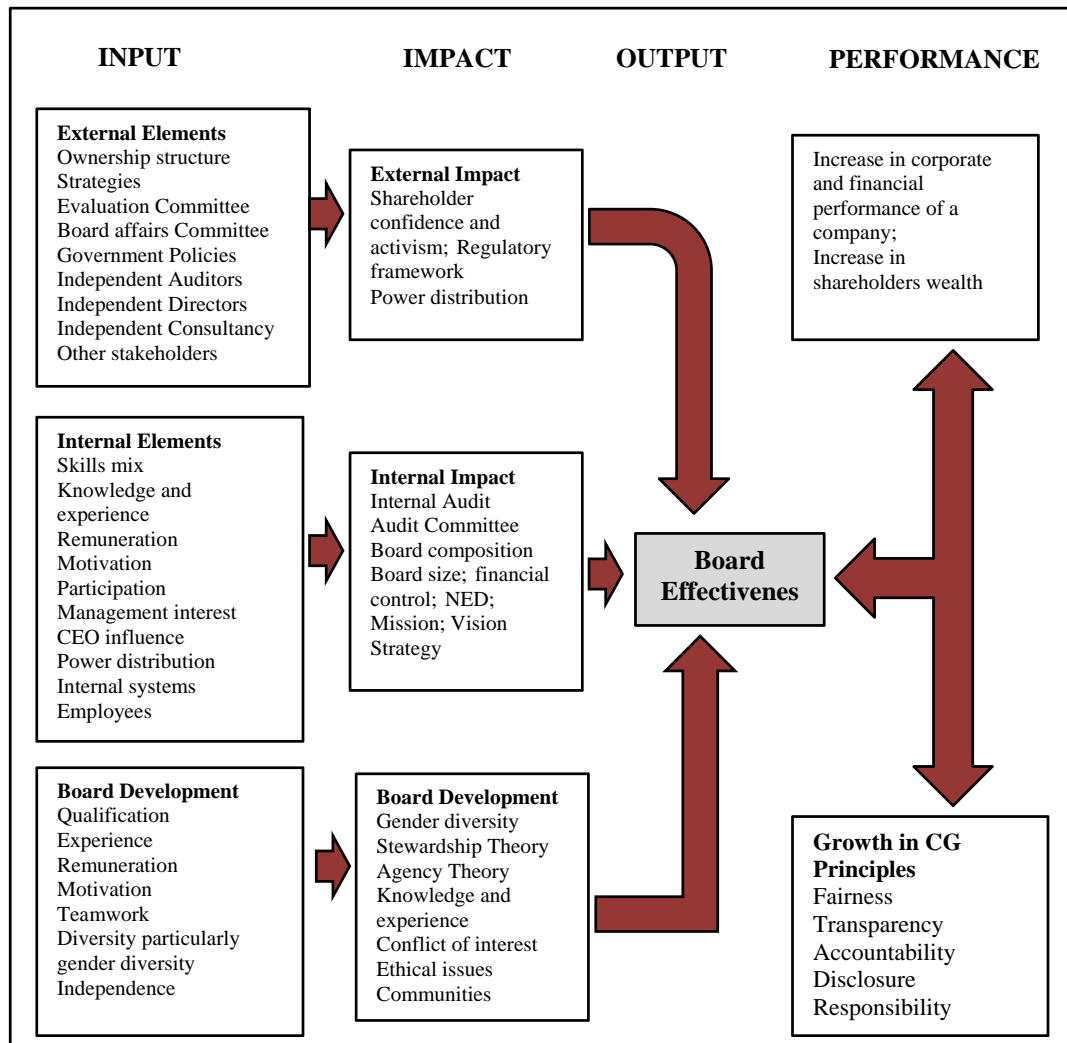


Figure 6.4: Board Effectiveness Model¹⁶⁰

6.7.1 Directors' Appointment Process

For the effectiveness of a corporate board the appointment process of directors should be fair and rigorous. For example, the UK CCG 2014¹⁶¹ provides a strict, formal and translucent mechanism for appointing directors to BODs such as; the selections should be made on merit, by considering the benefits of diverse board, including gender, to uphold a suitable equilibrium of experience, skill, knowledge

¹⁶⁰ Developed by the researcher

¹⁶¹ Section B of the Code of Corporate Governance of the UK 2014.

and independence on the board and within the company.¹⁶² A nomination committee is established to perform this task. The majority of nomination committee's members should be independent NEDs.

The chairman should be a NED and he should be the head of that nomination committee, but the committee should not be presided over by chairman when the meeting of committee is for the purpose of appointing a successor to the chairmanship. Moreover, NEDs should be hired for a particular time-period subject to re-election following statutory provisions regarding removal of a director. The term beyond six years for NEDs should be subject to laborious review specifically, and should consider the need for enlightened revitalising the board.

The annual report ought to comprise a separate section explaining the work of committee, including the process it has used regarding the selection of BODs. This section should explain the policy of board regarding diversity, comprising gender, every assessable aims that it has set for executing the strategy, and development in accomplishing those aims. Lastly, the search consultancy of the director should also be explained in the annual report.

South African King III has the mechanism of directors' appointment¹⁶³ on the lines of the UK: through nomination committee but subject to shareholder endorsement when required, a rigorous and formal process on merits. According to King III, shareholders are eventually accountable for the configuration of board and it is for their benefit to ensure that the board is constituted appropriately.¹⁶⁴ However, the CCG of Pakistan does not have any provision concerning the appointment of directors, which is another basic lacuna in the CCG of Pakistan.¹⁶⁵

¹⁶² Financial Reporting Council, *The UK Corporate Governance Code 2014* (2014)

¹⁶³ Principle 2.19 of King III Report.

¹⁶⁴ IOD, Draft Code of Governance Principles for South Africa – 2009 King Committee on Governance' 21 <www.iodsa.co.za> accessed 20-02-2015

¹⁶⁵ Other weakness, lacunas and overlapping provisions of code and corporate laws of Pakistan have been identified in the previous chapter.

The CCG of Pakistan contains the clauses regarding the appointment and removal of CFO, CS and Head of IA¹⁶⁶ but not for the hiring and firing of directors.

The researcher argues that how is it possible that the policy makers ignore to formulate and add the mechanism for the hiring and firing of members of most important entity of a company; around which the whole business of a company depends. The directors are appointed on the basis of personal and political benefits in SOEs and in family owned companies the owners acts as directors and appoint their family members or major children as NEDs.¹⁶⁷

The Ordinance¹⁶⁸ and the CCG¹⁶⁹ contain provisions regarding the qualification of directors which do not specify a fair and rigorous appointment and removal mechanism instead the positions and circumstances which debar a person to act as a director; for example, an insane, minor, defaulter etc.

Neither the Ordinance nor the CCG recommends any educational requirement for a person to be eligible for the office of directorship in Pakistan. Though, the office of directorship owes many important responsibilities, the person acting as director therefore, must be qualified, experienced and competent for the proper running of this office. Only learned directors having professional qualification and experience would be able to implement CG norms in listed companies in their true sense.

However, non-professional and uneducated ignorant persons cannot be rationale and prudent directors. Such directors would be harmful for the investments of shareholders. Hence, there should be specific provisions in the CCG or in the Ordinance to prescribe specific and precise criteria to be fulfilled by the person wish to act as director.

¹⁶⁶ Clause (xii) of the CCG 2012

¹⁶⁷ The researcher made this observation while going through the websites and annual reports of various companies of Pakistan, and during an informal conversation with a secretary of a company.

¹⁶⁸ Section 187 of the Companies Ordinance 1984

¹⁶⁹ Clauses (iii, iv and v) of the CCG.

The PICG should make endeavours to train directors and make them aware appropriately with corporate laws and their implementation. The persons should be disqualified from being directors of a listed company who do not consider it important to attend trainings and do not pass examinations. The application of this rule of compulsory certification for the directors will be proved beneficial in reducing corporate disasters and will also help to support the professional and accountable part of directors.

Moreover, the criteria of minimum qualifications should be same for the both investing and investee companies. More experienced and well educated directors will also help IIs to play their role in improving CG practices in listed companies by understanding and supporting their long-term policies for the betterment of shareholders and companies.

The researcher further argues that, the provisions must be added in the CCG of Pakistan defining a rigorous and formal appointment procedure for directors both executive and non-executive considering the skills, experience, and diversity and most importantly independence of directors, as such provisions are included in the CCG of the UK and King III of South Africa.¹⁷⁰ The argument is that, it is inevitable for a corporate board to be effective and it can only be done if the directors are to be appointed on merit undergoing a strict process based on their, knowledge, experience and abilities.

6.7.2 Director Development

The development of directors is essential for an effective corporate board. Therefore, the UK CCG 2014 requires¹⁷¹ all directors to undergo induction when they join board and should continue to take updated trainings regularly in order to refresh and maintain their skills and knowledge. It is the duty of the chairman to make sure that the directors update their knowledge, skill and acquaintance with

¹⁷⁰ As mentioned in previous paragraphs

¹⁷¹ Section B of the UK Code of Corporate Governance 2014 <<https://www.frc.org.uk/Our-Work/Publications/Corporate-Governance/UK-Corporate-Governance-Code-2014.pdf>> accessed 20 August 2015

the company regularly necessary to perform their role. The company is responsible to provide the required resources in order to keep directors' knowledge and competences updated. It is necessary for directors to have proper awareness of the company and access to its procedures and staff in order to work effectively.¹⁷²

Similarly, King III implies that there should be a formal procedure to conduct trainings and ensure development of directors.¹⁷³ All newly appointed directors should be educated regarding their roles, responsibilities, powers and potential liabilities; particularly those having no or limited experience. For this purpose, an experienced director may act as mentor to train new directors. Directors should receive consistent updates on relevant matters of company's business, amendments in laws, regulations, policies and standards of the company, and the atmosphere in which company operates. Moreover, it should also be the responsibility of chairman to remove incompetent directors according to the relevant legal and other procedural requirements.

The CCG 2012 of Pakistan has mandatory provision regarding directors' training.¹⁷⁴ The CCG makes it obligatory for all listed companies to take proper measures for arranging induction courses to acquaint their directors with the applicable laws and their responsibilities so that they could manage the companies' affairs successfully on behalf of the shareholders. The CCG also makes it compulsory for directors of registered companies to have certification offered by institutions (domestic or foreign) that fulfils the standards prescribed by SECP under any director's training programme.

For this purpose, the CCG requires at least one director every year to be certified under this training programme starting from 30th June 2012 to 30th June 2016; after that it would be compulsory for all directors to be certified. However, the person having 14 years of education and 15 years of experience (either in local or foreign institution) would be exempted from having this training certification.

¹⁷² Ibid

¹⁷³ Principle 2.20 of King III Report

¹⁷⁴ Clause xi of the CCG of Pakistan 2012

Further, CCG of Pakistan also provides the criteria for institutions that provide directors' training program and also provide the programme outline as well.¹⁷⁵

6.7.3 Frequency of Board Meetings

Frequency of board meetings mean the number of board meetings often occur and these meeting are a contributing factor for making the corporate boards effective, as the directors ought to be able to assign adequate time to the company to fulfil their duties appropriately.¹⁷⁶ The association between the regularity of board meetings and companies' outcome is another internal CG matter that highlights the concern for policy-makers and researchers.¹⁷⁷ There are two different opinions regarding this issue: those who are in favour of higher frequency of board meetings and,¹⁷⁸ those who are not.¹⁷⁹

One view is that the frequency of board meetings shows the strength of a board's actions, and the excellence of its monitoring.¹⁸⁰ A contradictory view is that board meetings are not essentially valuable for shareholders as board meetings are expensive in terms of both time and cost.¹⁸¹ King II and the JSE's Listings Rules task South African listed companies to set out a strategy for the aim, frequency, duration and conduct for the meetings of BODs and board subcommittees' meetings. It is recommended by King II specifically that all corporate boards should meet regularly, at least once a quarter, and it must be revealed in their annual reports. This indicates that the higher occurrence of board meetings is expected to impact positively on company's financial performance by King II.

The researcher submits considering the both points discussed above that, instead of arranging numerous meetings of board, establishing a system responsive to particular challenges would prove more fruitful. For instance, the meetings can be

¹⁷⁵ The Code of Corporate Governance of Pakistan 2012

¹⁷⁶ Financial Reporting Council, *The UK Corporate Governance Code 2014* (2014)

¹⁷⁷ Ibid (n 7)

¹⁷⁸ Ibid (n 2)

¹⁷⁹ Ibid (n 4)

¹⁸⁰ Vefas (ibid 72) 116; Conger *et al.*, 'Appraising Boardroom Performance' (1998) 76(1) Harvard Business Review 142

¹⁸¹ Vefas (ibid 72) 118

organised more frequently in case of crisis; such as when the replacement of CEO is required, shareholder's interests are visibly in danger or combating aggressive takeovers and when risks are involved. As the sole idea is that the directors ought to give adequate time to the company in order to fulfil their duties appropriately.

6.7.4 Supervisory Board

There is a proposal regarding the establishment of a supervisory board in Pakistani companies like China.¹⁸² The CCG for Chinese listed companies requires the establishment of a 'Supervisory Board' in order to monitor the legitimacy of directors, performance of management's responsibilities and safeguard the legal rights of company and shareholders.¹⁸³

Similar suggestions are also floating regarding Pakistan that, the CCG of Pakistan may also recommend setting out a supervisory board for the monitoring of managers, directors and auditors. The supervisory board ought to investigate the financial matters of a company. The members of supervisory board should be experts of corporate laws and this board ought to be administered through the regulations set out in articles of association (AOA) of a specific company. This board may act as a bridge between shareholders and company.

The advocates of supervisory board further argue that, this board should have meetings with individual and institutional shareholders in order to resolve issues originating from conflict of interests. This board ought to be able to organise periodical meetings. The directors, managers and auditors should attend these meetings to discuss significant issues of company and to address questions raised by the board. The recommendations of this board should be considered seriously in AGMs. This board can help to develop CG practices, if the members of this board have direct access to regulatory authority to inform them about any abuse of law by the company or its directors. The exponents of supervisory board believe that it will increase transparency of financial statements and will help to eradicate corruption from management.

¹⁸² Ibid (n 156) 20

¹⁸³ Code of Corporate Governance for Listed Companies in China, 2001

However this researcher submits that, supervisory board is not a suitable proposal for Pakistani companies. Firstly, to have a supervisory board would be an extra burden as it will enhance the cost, and there will be a long chain of management that could increase the problems rather to solve some. Secondly, establishment of a supervisory board can affect the relationship of shareholders especially institutional shareholders with companies and may not leave the room for their participation in the company matters as in Germany and China. All the functions which are proposed to be performed by supervisory board can be done effectively by creating a proper balance in the board members; for instance, by enhancing the number of INEDs and by giving a proper place to institutional shareholders in the board and likewise establishing a proper mechanism of check and balance.

6.7.5 Evaluation of BODs

The corporate boards need to be monitored regularly in order to improve their performance. To achieve this, the board should be assessed; this assessment would provide a valuable feedback which will help to improve its effectiveness, maximise its strong aspects and will focus on areas that require improvement. However, the procedures of assessment should be impartial and rigorous.

For example, the UK CCG requires¹⁸⁴ that the board ought to conduct a formal and harsh assessment of its individual directors, committees and of its performance annually. During this evaluation process, experience, balance of skills, knowledge, independence, diversity of board, including gender, working strategies of board, and other factors relating to its effectiveness should be considered. The chairman should supervise assessment process and take measures appropriate on the basis of the valuation of outcomes by identifying the powers and the weaknesses of the board. There should also be an individual assessment in order to get insight whether each director remains to add appropriately and to determine dedication to his responsibilities.

¹⁸⁴ Section C of the Code of Corporate Governance of the UK 2014.

Similarly, King III¹⁸⁵ also provides a detailed procedure for the assessment of board, its committees and individual directors in South African companies. However, CCG of Pakistan does not contain any such provision. Therefore, it is recommended that Pakistan's CCG should provide detailed and obligatory provision regarding the regular evaluation of corporate board, its committees and the individual directors of listed companies.

The reason is that this assessment and accountability is necessary for a corporate board to improve its performance, in order to safeguard the stakes of shareholders. The credit rating agencies, financial press and media can play their role in this by increasing and decreasing the rating of companies and highlighting and making comparisons of companies whose boards are conducting regular assessments or not. The IIs can also play an effective role in this regard by raising their voice in the meetings of BODs or highlighting the importance of this assessment during informal meetings and negotiations.¹⁸⁶

In short, it can be concluded on the basis of above discussion that, the effectiveness of corporate board depends upon its diversity, composition, process and independence. Moreover, board's functions are directly related to its members therefore, board's effectiveness depends on director's effectiveness. The diagram below presents this relationship of board and directors.

¹⁸⁵ Chapter 2 Principle 2.22 of the King III Report of South Africa

¹⁸⁶ This point is discussed in chapter 7 (section 7.8.1).

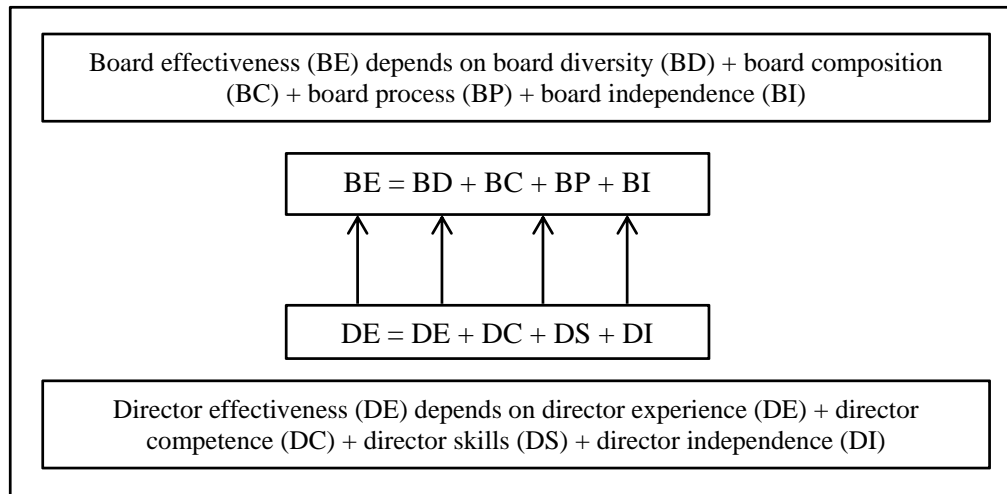


Figure 6.5: Relationship between Corporate Board and its Directors¹⁸⁷

The table below presents the attributes of corporate board structures which make a board effective improves its performance and has been examined above in this chapter by both theoretical and empirical studies.

Table 6.2: Attributes of Board Structure and Performance¹⁸⁸

Inputs	Structures	Developments	Outcome
Diversity of skills and experience	Board size and frequency of meetings	The board and management share a common vision of their goals and decide how it should go about achieving its goals	Identifying the goals and principles of company; making strategies to achieve those goals
BODs give proper time to perform their duties	Quorum to attend meetings	The board is fully aware with its responsibilities	Monitoring the performance of company and taking required action in a particular situation.
	Establishing formal subcommittees	The board reviews and evaluate the working of sub committees regularly.	Appointing and supervising the CEO or senior staff and directing management
	Creating jobs for board members with written explanations	Ensuring good communication and diminishing confusions between management and the board.	Employing new board members; monitoring board performance to ensure its excellent working

¹⁸⁷ Developed by the researcher

¹⁸⁸ Developed by the researcher

	Trainings and orientation for newly appointed members of board	The management and board can resolve their conflicts constructively. The board has sufficient information regarding the agenda of board meetings; and meetings are clearly structured; significant issues are highlighted to discuss on priority; it is evident who has obligation for following up activities decided by the board.	Making sure that company meets its legal requirements e.g. submitting annual returns; ensuring accountability to the company's stakeholders; representing stakeholders' interests; taking charge when things go wrong and representing the company externally
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6.8 Conclusion

This chapter has examined the attributes of BODs which make corporate boards better and effective. It found that more diverse boards bring range of experience, skills and talent to the BODs and gender-balanced corporate boards work more efficiently, effectively and they are more disciplined and highly focussed. The current chapter established that by creating an effective system of check and balance can influence the directors' performance in order to meet shareholders' expectations. It can be done via enhancing the number of INEDs in Pakistani corporate boards from one to at least half of the board, and to give a proper representation to IIs in BODs.

Directors' appointment procedure should be transparent and on merit, independent from political influences. In order to enhance the competency of directors, they should have appropriate training at the start and during their job in order to be acquainted with new laws, policies and regulations. Their performance must be evaluated regularly together as BODs and individually.

The current chapter developed the board effectiveness model for the listed companies of Pakistan and established that better performing corporate boards help in developing CG principles and practices in their companies. The next chapter examines the role of IIs in promoting the CG principles in the listed companies of Pakistan.

CHAPTER SEVEN: THE ROLE OF INSTITUTIONAL INVESTORS IN PROMOTING CORPORATE GOVERNANCE

7.1 Introduction

The previous chapter examined the role of board of directors (BODs) and its impact on corporate governance (CG) practices in their companies and developed a model for the effectiveness of BODs in the listed companies of Pakistan. The idea behind the development of board effectiveness model is that, more effective BODs help to improve not only companies' financial performance and maximise shareholders' wealth, but they improve and promote CG practices as well. Companies having better governing boards have better performance.

The current chapter relates to the fourth and last objective of this thesis and investigates the part of institutional investors (IIs) in promoting CG practices and explore their role and measures by which they can contribute towards enhancing the compliance with code of corporate governance (CCG) and improve CG practices in the listed companies of Pakistan.

To explore the role of IIs is important because of the fact that, they are large organisations who collect money from individuals and companies and invest on their behalf being experienced and expert of financial matters and corporate ventures. Their clients have confidence in their skills that due to their professionalism and owning large shareholdings they can have a better say and influence the companies' strategies and monitor the decision-making of BODs. Secondly, in the course of recent decades, IIs have grown impressively in size and

are included in various parts of the economy;¹ therefore the examination of this issue is crucial with a specific end goal to evaluate their impact. They can impact the kind of companies they put resources into, change share prices and switch in and out of assets, with noteworthy consequences on the values of shares and resultantly the economy as well.²

Therefore, this chapter seeks to explore what role IIs can play in the listed companies of Pakistan in order to improve CG practices there. The following figure presents the plan of this chapter.

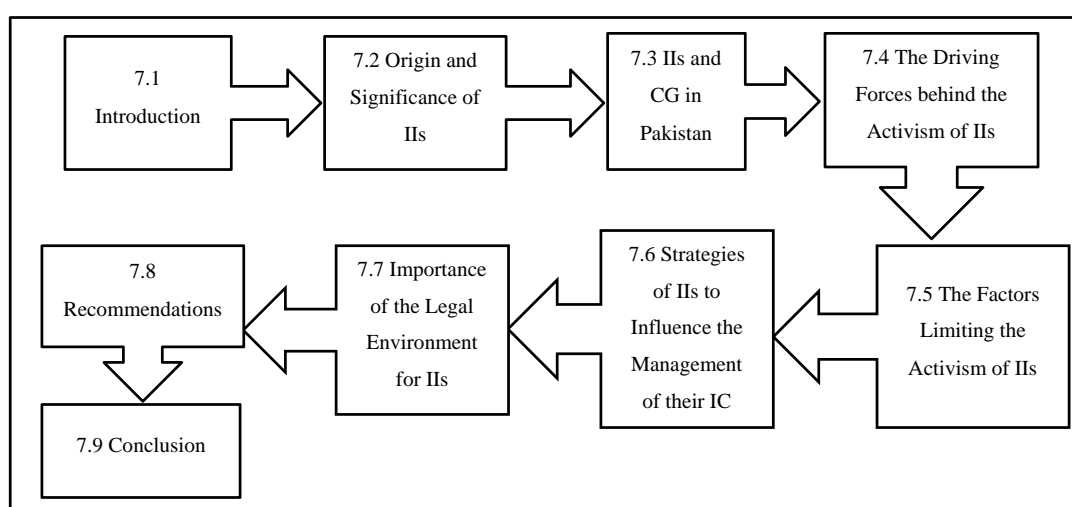


Figure 7.1: Plan of this Chapter

7.2 The Importance of Institutional Investors

The IIs activism seems to be the ultimate means for steady improvement in CG standards, as well as a powerful tool for re-focussing short-term strategies towards more sustainable and viable business projects.³ The IIs are financial mediators

¹ Syeda Shabbir, 'The Role of Institutional Shareholders Activism in the Corporate Governance of Pakistan' (2012) 1(2) Journal of Humanities and Social Sciences 1

² Stephen Bainbridge, 'Shareholder Activism and Institutional Investors' University of California Los Angeles Law and Economics Research Paper No. 05-20, <http://papers.ssrn.com/so13/papers.cfm?abstract_id=79622> accessed 15 May 2015

³ Konstantinos Sergakis, 'EU Corporate Governance: The On-going Challenges of the 'Institutional Investor Activism' Conundrum' (2013) 4 European Journal of Law Reform 728

who give liquidity to short-term financial markets and do long term investments in the capital market.⁴

A standout amongst the most critical components of the capital market throughout the recent thirty years has been the growth of IIs.⁵ This development has prompted the framework being depicted as money manager capitalism.⁶

In 1980s in the UK the trend of privatisation prompted an inversion in this development of IIs by considerably expanding the quantity of minority shareholders and private investors. Nevertheless, the breakdown in the share values in 1987 prompted to a lack of trust of minority shareholders and private investors and thus the pattern of IIs' predominance emerged again.⁷

The IIs are associations that gather huge amounts of money and invest those amounts in companies. They can assume a self-assured part in advancing CG practices in the listed companies of Pakistan through effectively taking an interest in the undertakings of investee companies.⁸ However, this fact about IIs has not been much considered, researched and given required importance yet in Pakistan. The reason could be the convergence of share ownership in the hands of individual shareholders or block-holders (SOEs and FOEs).

Shareholders are frequently portrayed as proprietors of companies,⁹ which imply that owning shares in companies is equivalent to being owners of any other property. Therefore, being proprietors of companies, they can train a wild corporate framework. They might be individual investors or IIs. IIs are considered to have superior opinion in the administrative undertakings of their investee company due to their large shareholdings in contrast to individual shareholders. Therefore, they can be influential as specialists of progress towards enhancing CG

⁴ Stuart Gillan and Laura Starks, 'The Evolution of Shareholder Activism in the United States' (2007) 19(1) *Journal of Applied Corporate Finance* 55

⁵ Helen Short and Kevin Keasey, 'Institutional Shareholders and Corporate Governance in the UK' in Kevin Keasey *et al*, (eds) *Corporate Governance Accountability, Enterprise and International Comparisons* (John Wiley and Sons Ltd 2005) 61

⁶ *Ibid*

⁷ *Ibid* (n 5) 60

⁸ *Ibid* (n 1) 3

⁹ Robert Monks and Nell Minow, *Corporate Governance* (England Blackwell Publishing 2004) 98

practices.¹⁰ However, individual investors cannot influence the investee companies' affairs being in small numbers owning small shares.

7.2.1 Institutional Ownership

Institutional ownership can be described as number of shares owned by financial and non-financial institutions called IIs.¹¹ These incorporate both the public and private institutions. Generally institutions are characterised as shown in figure 7.2.

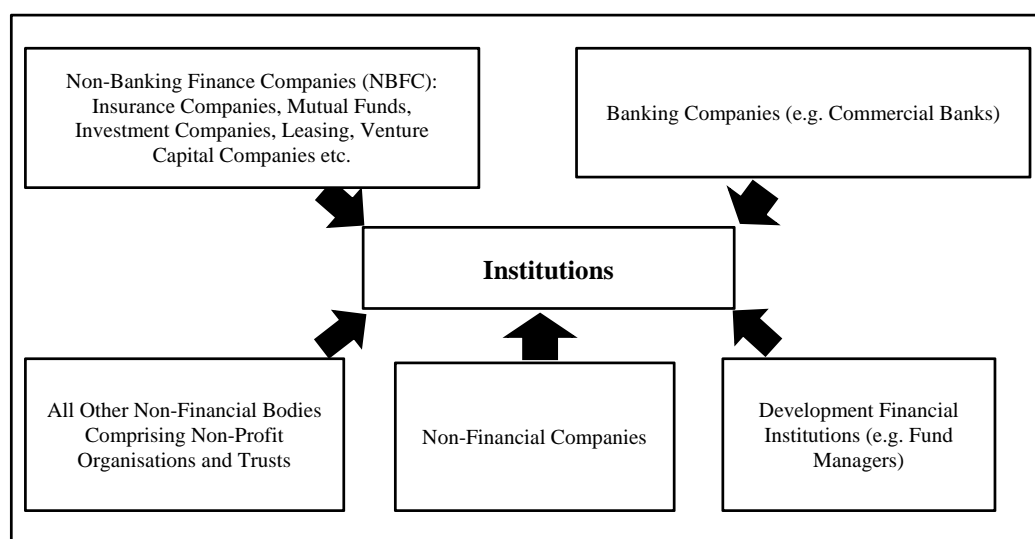


Figure 7.2: General Types of IIs¹²

The aims of financial institutions are to advance proficient allotment of assets, reduce the fee of business contracts, and give liquidity to shareholders and productive monitoring of projects.¹³ IIs offer more prominent motivations to collect information due to the fact that trading happens on the premise of that information. This information is also described as the share price.¹⁴

¹⁰ Shahnawaz Mahmood and Haroon Sharif, 'Institutional Shareholders and their Role in Promotion of Corporate Governance in Pakistan' Working Paper
<http://www.secp.gov.pk/IACCD/pub_iaccd/WORKING%20PAPER.pdf> accessed 1st September 2014

¹¹ Ibid

¹² Developed by researcher

¹³ Marcia Cornett *et al.*, 'The Impact of Institutional Ownership on Corporate Operating Performance' (2007) 31 Journal of Banking and Finance 1771

¹⁴ According to efficient market hypothesis

Moreover, IIs also provide ways for resourceful risk distribution and expansion. Thus, risk return inclinations of all types of investors can be fulfilled. While weak corporate performance will reduce share value which can bring about takeover and dismissal of administration. In this manner, efficient market framework comprising on IIs keep up administrative motivations to maximise turnover.¹⁵

The unique qualities of the IIs incorporate considerable investment and diversified alignment.¹⁶ They invest and oversee assets in the interest of other shareholders. They retain the powers of voting on behalf of shareholders and have professional portfolio managers who bring more expertise in contrast to individual investors. As the financial institutions (IIs) hold large shareholdings, they can lessen the evading conduct of managers by monitoring their actions and convince them to increase shareholder wealth.¹⁷

Nevertheless, IIs have been criticised for not putting adequate assets and efforts in monitoring the actions of corporate managers.¹⁸ They are normally either voting in favour of managers or declining voting. This unwillingness to vote against administration is due to the conflict of interest created by their different business relations with companies.

7.2.2 Shareholders' Engagement

Shareholder engagement or shareholder activism is a path by which shareholders can declare their influence as owners of the company's assets in order to have impact on the affairs of that company.¹⁹ Institutional shareholders' activism is characterised as checking of execution and CG of their investee companies.²⁰ However, the extent of activism extends to the endeavours rolled out to realise

¹⁵ Admati *et al.*, 'Large Shareholder Activism, Risk Sharing and Financial Market Equilibrium' (1994) 102(6) *The Journal of Political Economy* 1097

¹⁶ Ibid (n 5) 65

¹⁷ Ibid (n 15)

¹⁸ Almazan *et al.*, 'Active Institutional Shareholders and Costs of Monitoring: Evidence from Executive Compensation' (2005) 34(4) *Financial Management* 5

¹⁹ The European Corporate Governance Institute (ECGI) <<http://www.ecgi.org/activism/>> accessed 20 June 2015

²⁰ Andrei Shleifer and Robert Vishny, 'Large Shareholders and Corporate Control' (1986) 94(3) *Journal of Political Economy* 461

improvements in a company's conduct and develop awareness regarding the benefits of adopting code of corporate governance (CCG).

By and large, the activism of IIs fulfils two fold purpose, they purchase shares in a company being block-holder with a determination to influence and alter the policies and decision-making of not only of a company but also of a capital market for the purpose of corporate control.²¹ The part of IIs developed in the UK and the US, because of the decrease in the individual share ownership and growth in large shareholdings invested by financial institutions, in the twentieth century.²² Today, IIs are assuming a crucial part in the CG of numerous advanced jurisdictions.

On the other hand, Pakistan has a minimalist corporate culture, because of the fact that numerous companies are owned and managed by families.²³ IIs are represented in only a small portion of securities market. Though, they have been noticed to grow remarkably and started to get importance in the corporate sector of Pakistan.²⁴

The critical element related to IIs activism is their noteworthy shareholding. This is tantamount in two ways: larger shareholding when contrasted with others or holding of more noteworthy than a basic sum as ratio of aggregate equity. This implies that influence of institutions on management increments and along these lines decreases the issue of combined action. On the other hand, small or individual shareholders have less or no motivating force to attempt the monitoring of directors' actions as a result of the costs included in such activities and 'free-

²¹ Yiwei Dou, 'Block Holder Heterogeneity and Financial Reporting Quality' (2013) <http://mitsloan.mit.edu/events/asia-conference-in-accounting/pdf/Blockholder_Heterogeneity_and_Financial_Reporting_Quality.pdf> accessed 10 February 2015

²² Anat Admati and Paul Pfleiderer, 'The Wall street Journal and Shareholder Activism: Exit as a form of Voice' (2009) 22 Review of Financial Studies 2445

²³ As discussed in previous chapters.

²⁴ It is evidenced below section 7.3.

rider' issue.²⁵ Therefore, IIs having large amount of holding can handle the cost incurred from monitoring.

However, the conflicts of interest might prompt the passivity of IIs. For example, agency issues emerge because of the parting of ownership and control. The authority to run a company is delegated to directors by shareholders (owners). The directors are tending to take decisions on the premise of self-interest, for example, they may concentrate on short-term advantages to the detriment of long-term benefits which is not judicious. At the point when the board of directors (BODs) does not give weightage to the contentment of shareholders and does not act for their benefits, the activism on the part of shareholders becomes vital.²⁶

Moreover, the IIs are more vigorous in their activities when they synchronise and cooperate among themselves. Along these lines the advantages can be enjoyed by all and in the meantime expenses can be shared. This could be accomplished in two ways: every institution playing a lead part in monitoring of a company in which it has large shareholding or all IIs acting jointly. The first choice is by all accounts more reasonable because of the fact that the substantial shareholder will earn maximum profit and therefore it has sound incentives to be active.²⁷

7.2.3 Historical Growth of Shareholders' Activism

Shareholders' activism is not a new notion. Its origins were already present in the corporate world however, were developing with slow speed.²⁸ For instance in the USA, the concept of shareholders' activism emerged in early nineties when the financial institutions, for example mutual funds, banks and insurance companies were effectively taking an interest in the corporate governance (CG) of the country. However, throughout the following three or four decades, laws were formulated with the intent of constraining the influence of those financial

²⁵ Free-rider problem means that one shareholder bears the cost and has to do efforts; however the benefit is enjoyed by all shareholders.

²⁶ Ibid (n 22) 2447

²⁷ Moshe Pinto, 'The Role of Institutional Investors in the Corporate Governance' (PhD Dissertation, University of Hamburg and Bolonga 2005)

²⁸ Mark Roe, 'Political and Legal Restraints on Ownership and Control of Public Companies' (1990) 27 Journal of Financial Economics 7

mediators which resultantly prohibited them from having a dynamic part in the CG of country.²⁹

Later on, the Securities and Exchange Commission (SEC)³⁰ was set out in the US, with the aim of reinstating shareholders' trust in capital markets by introducing the practices of disclosure which can provide more reliable evidence and strong principles of truthful dealing to shareholders and to the market. The SECA also allowed shareholders to present their particular suggestions for consideration on corporate ballots.

The shareholders activism in the US from 1942 to 1970s was controlled and commanded by individual investors.³¹ The role of IIs picked up dominance in the 1980s when the pension funds turned out to be effectively included in requesting assurance of their interests as stockholders. After few years, the overwhelming part and involvement of pension funds, insurance companies and banks is noticed as IIs.

Similarly, in the UK the activism of IIs developed with the transformation of share ownership from individual investors to large institutions. The part of IIs was acknowledged by diverse CCG and reports issued over time.³² In 1991, the Institutional Shareholders Committee (ISC) was set up in the UK. It serves as a platform to IIs to discuss their policies and organise their activities for the protection of shareholders' rights. The ISC set out its 'Statement of Principles' in 2002, defining the role and responsibilities of IIs. The reason for issuing these principles was to guarantee the use of best practices to the connection between IIs

²⁹ Ibid

³⁰ Under the SEC Act 1934.

³¹ Stuart Gillan and Laura Starks, 'The Evolution of Shareholder Activism in the United States' (2007) <<http://ssrn.com/abstract=959670>> accessed 1st September 2014

³² Bob Wearing and Yuval Millo, 'Activist Investors in UK Quoted Companies And The Implications for Corporate Governance' <<https://www.icaew.com/~media/corporate/files/technical/corporate%20governance/uk%20corporate%20governance/tecpln10783%20activist%20investor%20report%20final%20reduced.ashx>> accessed 15 July 2015

and their investee companies, in order to secure worth for beneficiaries³³ for a longer period.³⁴

In Pakistan the situation is different being the concentration of large shareholdings in the hands of families and SOEs.³⁵ However, this trend is changing now gradually and financial institutions are becoming influential investors along with the individual investors. For example, in a reported case of Pakistan,³⁶ three companies filed a petition under sections 284 to 288 of the Ordinance,³⁷ looking for assent of the court to a plan of course of action endorsed by their investors in general meetings.

The investors had contradicted the plan of merger for substantial causes archived by audited accounts of the petitioner companies. The High Court held in its decision that if there should be an occurrence of merger of companies: “Directors cannot act self-assertively while propositioning such plan. Directors might have preference in choosing one of several appropriate strategies, which might precede them for attention, yet they have no preference to pick a strategy not in the light of a legitimate concern for shareholders.”

In Pakistan, activism with respect to shareholders is in a developing process; they are inclined towards transient interests so as to increase fast returns while investors in advanced jurisdictions prefer long term investments.³⁸ However, the researcher submits that, this is not true, IIs even in developed countries prefer short-term investments due to certain problem which they face while making investments such as, agency problems, free-rider problems, conflict of interest etc. The researcher further submits that, there is absence of an organised level of

³³ Beneficiaries are shareholders on the behalf of them IIs make investments.

³⁴ Institutional Shareholders’ Committee, ‘The Responsibilities of Institutional Shareholders and Agents – Statement of Principles’
<http://www.plsa.co.uk/PolicyandResearch/DocumentLibrary/~media/Policy/Documents/0039_ISC_Statement_of_Principles_2007_0607.ashx> accessed 20 July 2015

³⁵ As discussed and evidenced in previous chapters.

³⁶ *Kohinoor Raiwand Mills Limited through Chief Executive Versus Kohinoor Gujar Khan Mills and other* (2002 CLD 1314)

³⁷ The Companies Ordinance 1984

³⁸ Ali Ibrahim, ‘Corporate Governance in Pakistan: Analysis of Current Challenges and Recommendations for Future Reforms’ (2006) 5(2) Washington University Global Studies Law Review 323

shareholder activism in Pakistan, which can develop with the development and activism of IIs. The IIs can contribute towards stabilising the capital market in Pakistan and developing the CG principles in it.

7.2.4 Shareholder Activism and Institutional Investors: Problems in Collective Action

The activism on the part of shareholders is a typical issue in dispersed ownership frameworks.³⁹ Dispersed shareholding makes it difficult to direct and monitor the activities of management. In the frameworks of concentrated ownership, some block holders own the majority shareholdings and therefore, the minority shareholders do not own enough shares to influence the management of their investee companies in terms of adopting and implementing CG principles. Therefore, shareholder activism might likewise be a problem in these frameworks.⁴⁰

The quick changes in ownership structures, because of rapid share trading as well as the absence of harmonisation in combined activities are serious concerns. This researcher argues that, the concern of the fast change in ownership framework can be comprehended by IIs. The argument is that they hold shares in portfolio companies and issue units to their investors. Unit holders might alter their source yet shareholding remains steady in portfolio companies because of the specific nature of IIs. Therefore, they can influence the administration and BODs to develop CG of their investee companies.⁴¹

Furthermore, the cost involved in taking action to influence the companies is additionally a major concern. If an individual investor or minority shareholders aim to discipline and impact BODs, it can be excessively costly for them if

³⁹ Luca Enriques *et al.*, 'The Basic Governance Structure: Minority Shareholders and Non-Shareholder Constituencies' in Kraakman *et al.* (eds), *The Anatomy of Corporate Law: A Comparative and Functional Approach* (2nd edition, Oxford University Press 2009) 89

⁴⁰ Ibid

⁴¹ Andreas Jansson, 'Collective Action Among Shareholder Activist' (PhD Thesis, Vaxjo University Sweden 2007); Edward Rock, 'Institutional Investors in Corporate Governance' (2015) Research Paper No. 14-37 <<file:///C:/Users/BMRI/Downloads/SSRN-id2512303.pdf>> accessed 10 March 2016

weighed up against the probable advantage of such actions. Therefore, this might not be an appealing strategy for individual investor or minority shareholders since the benefits occur from such actions are shared with other investors too. However, IIs can be the solution to this issue due to their large shareholdings.⁴²

The cost of activism might be decreased if the action is taken through IIs, because in this way the expenses will be shared by all shareholders of IIs. They might agree to bear the cost acquired as this will be advantageous for them. Moreover, the action through IIs might have other advantages too. For example, the CG of investee companies will be enhanced which will be advantageous not just for the clients of IIs, but also for other shareholders of the investee companies. Moreover, the positive message will go to the market and other companies to develop their CG framework.⁴³

Furthermore, IIs can minimise directors' threat of removal through the risk of hostile takeovers, as the successful bidder might remove them.⁴⁴ While IIs activism might motivate directors to perform better for the improvement of the governance framework and emphasise on the long-term dreams of the company.⁴⁵ Though, the problem with such actions of IIs is that, they have to retain large shareholdings for a more drawn out period in order to influence the company's BODs for the advancement of CG principles and mechanisms, and this act of retaining shares for longer periods might cause liquidity problem. Therefore, the liquidity has to be relinquished for the purpose of getting long-term advantages from IIs activism.⁴⁶

⁴² Craig Doidge *et al.*, 'Can Institutional Investors Improve Corporate Governance Through Collective Action' (2015) 1

<http://www.ccg.ca/site/ccgg/assets/pdf/doidge_et_al_april_2015.pdf> accessed 04 July 2016

⁴³ Ibid; Iain MacNeil, 'Activism and Collaboration Among Shareholders in UK Listed Companies' (2010) 5 (4) Capital Markets Law Journal 424

⁴⁴ Robert Romano, 'Less is more: Making Institutional Investor Activism a Valuable Mechanism of Corporate Governance' (2010) 18(2) Yale Journal on Regulation 174

⁴⁵ Junghoon Park, 'Governance of and by Institutional Investors' (5th Roundtable on Capital Market Reform in Asia, Ministry of Finance and Economy, Republic of Korea Tokyo, November 19-20 (2003)) <<http://www.oecd.org/finance/financial-markets/19388822.pdf>> accessed 10 May 2015

⁴⁶ Ibid (n 42, 45)

There are diverse opinions in terms of the impact of IIs' activism on the outcome of their investee companies. Romano⁴⁷ argues that, there is no affirmative impact of IIs' activism on the outcome of investee companies empirically; instead, occasionally it has bad impact on the share values of respective companies.

Park⁴⁸ contends that IIs are not always considered expert and capable to solve the issues of the portfolio companies through such activism. He argues that, their involvement even weakens them regarding their principal responsibility for which they are established; for example, if a pension fund is engaged in such activism, IIs have been engaged with the management of investee companies in spite of focussing on the benefit of pensioners.

The researcher argues that, this assumption regarding the activism of IIs might be right however the potential advantages of this activism might be more prominent as compared to the drawback of the agency issue. IIs retain the shares of various companies and likewise, must have impact on the governance of their investee companies. Therefore, in the event that they enhance the governance of considerable companies, the effect of the activism might be more prominent in contrast to the agency issues in their investee companies.

Moving further, the researcher agrees with the Park's view that the clash of interest or irreconcilable circumstances is likewise a noteworthy issue in IIs involvement. For example, an II will be hesitant to make a move regarding an investee company if that company retains customer relations with the holding company of II.⁴⁹ Conflict of interest might likewise be obvious in the situation where the II is additionally a director in the portfolio company by uprightness of his own shareholding. Such II is not anticipated that would take any move against him as a member of the BODs.

⁴⁷ Ibid (n 44)

⁴⁸ Ibid (n 45)

⁴⁹ Ian Mac Neil (n 43) 428; Ian Mac Neil, 'Shareholders' Pre-emptive Rights' (2002) *Journal of Business Law* 78

Regardless of the above stated issues, the part of IIs has been viewed as being noteworthy in current years, particularly after financial disasters. IIs have been held responsible for their latent part in monitoring the BODs that added to the calamity.⁵⁰ They could influence the administration of their investee companies and enhance general CG frameworks however they neglected to make suitable move notwithstanding when this was for the benefits of their clients.⁵¹

The researcher submits that IIs can assume their part in enhancing the governance standards of their investee companies in many ways: such as, they can have negotiations with the directors; they might additionally chose directors for BODs and along these lines monitor the outcome of their investee companies. They can likewise go about as shareholders in AGMs to influence the administration to adopt and implement CG principles and standards.

7.3 Institutional Investors and Corporate Governance in Pakistan

Investment via investment funds⁵² has turned out to be more prominent these days. This type of investment is motivating for IIs due to the fact that they provide a level of divergence which is frequently not achievable for individuals to imitate in direct venture.

It additionally gives business market entrance to individual investors since a few issues of securities are open just to IIs, for example, American Depository Receipts (ADRs) and Global Depository Receipts (GDRs). They are worthwhile since they give respective jurisdictions admiration of managing, authority and exchange of securities because the IIs advantage by working on a more drawn out measure.⁵³ They likewise tackle liquidity problems, in any event in State Owned

⁵⁰ 'A Review of Corporate Governance in UK Banks and other Financial Industry Entities: Final Recommendations (November 2009) 72

<http://webarchive.nationalarchives.gov.uk/+/http://www.hm-treasury.gov.uk/d/walker_review_261109.pdf> accessed 10 May 2015

⁵¹ Myners Review of institutional investment: Final Report, <http://archive.treasury.gov.uk/docs/2001/miners_report0602.html> accessed 10 May 2015

⁵² Franco Modigliani and Merton Miller, 'The Cost of Capital, Corporation Finance and the Theory of Investment' (1958) 48 *The American Economic Review* 261

⁵³ *Ibid* (n 49)

Enterprises (SOEs), which is a noteworthy issue in concentrated ownership business sectors, for example Pakistan.

The part of IIs in Pakistan is restricted and the fund industry is immature.⁵⁴ However, according to the researcher, there is considerable scope for them and IIs can solve the collective action problem and can assume a powerful part in the business sector of Pakistan in influencing the management of investee companies. IIs hold adequate shares to influence the administration of investee companies to develop CG standards. The IIs are usually skilled and have expertise of investment, and can have an impact on the management to adopt and implement CG principles. They have not assumed their due part so far in the development of CG in Pakistan. There is still a requirement for change in this segment, particularly relating to their part in negotiating with their investee companies.

The National Investment Trust Limited (NITL) and Investment Corporation of Pakistan (ICP) are the biggest financial specialists operating under state control. A large portion of the Asset Management Companies (AMCs), global joint investors, brokers, provident and private pension funds, and the mudaraba are small financial specialists operate as private investors in Pakistan.

The NITL was the primary finance management institution in Pakistan. The SOEs have 8.33% share assets directly and 50% share assets indirectly in NITL. The NITL retains share assets in majority of the listed companies of Pakistan. It had 81 billion Pakistani rupees under its management with 55,109 unit holders as on 30th June 2013.⁵⁵

The ICP was set up in 1966 by an ordinance issued by government of Pakistan (GOP). Its goals were to expand the roots of investments and improving the business market of Pakistan. The ICP endorses open community problems of

⁵⁴ Sikander Shah and Moeen Cheema, 'Corporate Governance in Developing Economies: The Role of Mutual Funds in Corporate Governance in Pakistan' (2006) 36 Hong Kong Law Journal 341

⁵⁵ The information is collected from the website of NITL, <www.nit.com.pk> and <http://www.nit.com.pk/index.php?option=com_content&view=article&id=14&Itemid=3%3E%20&%20%3C%20http://www.privatisation.gov.pk/Finance/nit.htm#> accessed 10 July 2015

shares and takes an interest in equity ventures. It unties and keeps up investors' records because of an end goal to enhance share ownership and broadening the roots of business sector by shares trading of listed companies for the shareholders. The ICP skims and deals with the mutual funds which offer chains of strong policies for shareholders looking for equitable outcomes via pooled investments.⁵⁶

The ICP additionally buys and offers shares on the stock market for its several companies. It has glided twenty five private and SOEs mutual fund with a perspective to provide chances of collective investment to shareholders. The companies' market dealings for its own particular portfolio, investors' portfolio and mutual funds' portfolios help in fortifying the movement in business sector.⁵⁷

The fund industry in Pakistan is relatively small and in developing stage.⁵⁸ It holds almost five per-cents of total market capitalisation. This researcher's view is that, IIs can play a major role here, because of having adequate voting rights to have representation in the BODs of their investee companies. Additionally, banks can make a condition of loan and therefore can choose their candidate as a director of a client company under the Ordinance.⁵⁹ For instance, NITL, a noteworthy investment institution can nominate and appoint directors on BODs of several companies and hence can assume a noteworthy part in advancing CG standards.⁶⁰

However, the operation these state-owned institutions such as, NITL and ICP is a significant issue for the growth of institutional investment. The state owns ICP and the majority of shareholdings of NITL.⁶¹ Therefore, the direct state control and interference in appointing directors on the basis of political affiliations instead

⁵⁶ Information is collected from the website of ICP, <<http://investment-corporation-of-pakistan-133684.pakbd.com/>>accessed 12 July 2015

⁵⁷ Information taken from <<http://www.privatisation.gov.pk/finance/icp.htm>> accessed 10 May 2015

⁵⁸ According to the association of Mutual Funds in Pakistan, <<http://www.mufap.com.pk/>> accessed 12 July 2015

⁵⁹ The Companies Ordinance 1984

⁶⁰ IMF Report on the Observance of Standards and Codes (ROSC) June 2005 on Pakistan

⁶¹ NIT website

<http://www.nit.com.pk/index.php?option=com_content&view=article&id=4&Itemid=5> accessed 10-05-2015

of skills, expertise and qualification creates serious governance issues. The researcher submits that, it is necessary to give careful consideration to the growth of IIs in Pakistan. The latent part of IIs, particularly those who are under state control, is one of the significant reasons as a result of which the investment institutions remain under-developed.

This section and the following two sections examine the current position of IIs and the fund industry working in Pakistan. The intention is to critique these facts in order to establish the scope of IIs in Pakistan, as these sections confirm that there is a considerable scope for them in Pakistan and they can make a huge contribution in promoting CG in Pakistani companies.

7.3.1 Institutional Shareholdings in Pakistan

This section examines the ownership structure of IIs in Pakistan. The overall number of companies listed on Karachi Stock Exchange (KSE) is 713, out of which financial and government owned companies are 208.⁶²

To observe the pattern of IIs, they were divided in the following categories as shown in Figure 7.3.

⁶² The information is collected from the website of SECP, <www.secp.gov.pk> accessed 12 July 2015

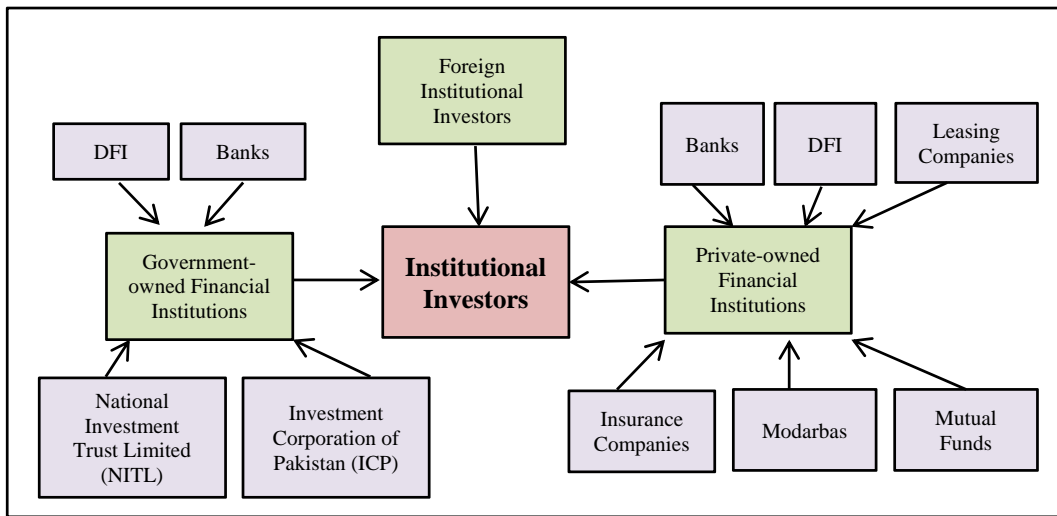


Figure 7.3: Categories of IIs in Pakistan⁶³

The capital market of Pakistan has certain features distinguished from other developed jurisdictions.⁶⁴ For instance: numerous listed companies particularly in the textile sector in Pakistan are family-owned.⁶⁵ This prompts insider control and concentrated ownership. The capital market is less developed, because of which dynamic trading is conducted in just a couple of companies. Additionally the number of new listings is also very less which imply less dependence on market for floating capital.

There is absence of market for corporate control and there is barely any occurrence of corporate control and takeovers. And the reason is the same that monitoring of ownership depends on directors; substantial dependence on Bank financing; share dissemination is done in a manner that the larger part of the shareholding is owned by directors directly or indirectly.⁶⁶

⁶³ Developed by the researcher (information is collected from the website of SECP).

⁶⁴ As discussed in chapter five (section 5.5)

⁶⁵ Hamid H and Koshich V, 'Corporate Governance in an Emerging Market: A Perspective of Pakistan' (2006) 1(1) Journal of Legal Technology Risk Management 22

⁶⁶ Ibid

Table 7.1: Pattern of Ownership in Pakistan’s Financial Sector Until on 30 June 2015⁶⁷

Financial Sector	Number of FIs	% of total
State-controlled Banks	5	17%
Local Private Banks	22	69%
Foreign Banks	7	2%
Specialised Banks	4	1%
Investment Companies	7	0%
Insurance Companies	47	5%
Development Finance Institutions	8	1%
Other	234	5%
Total	334	100%

Table 7.1 shows pattern of ownership in the financial sector of Pakistan. The interesting characteristic from this information is that Development Financial Institutions (DFI) has ended up being noteworthy equity holders with 8.56% holding. In Pakistan DFIs commonly assume a vital part in term-financing like several other developing jurisdictions. However, it is apparent from the table that financial institutions holding get to be inconsequential if bank holdings are uprooted.

One prominent element is that investment companies have very little equity holding. This could be because of market instability, less settled investment companies and absence of fund management aptitudes. Absence of advanced financial instruments and price revelation system in the market are additionally real impediments for non-bank IIs. The configuration of shareholding for financial institutions (both government and privately owned) across the sectors is provided below.

⁶⁷ Data taken from the website of SECP, www.secp.gov.pk/annualreport/2014/AnnualReport_2014.pdf accessed 20 March 2015

Table 7.2: Pattern of Shareholding in Different Sectors of Pakistan⁶⁸

Sector	Newly Incorporated Companies for the FY Ending 30-06-2014	Total Companies as of June 30, 2014
Auto and Allied	60	787
Broadcasting and Telecasting	68	567
Cables and Electrical	42	682
Carpets and Rugs	3	71
Cement	2	102
Chemical	75	1,643
Communications	173	2,662
Construction	306	3,162
Corporate Agricultural Farming	195	1,225
Education	132	999
Engineering	108	1,842
Finance and Banking	33	1,089
Food and Beverages	166	2,443
Footwear	5	75
Fuel and Energy	82	1,250
Ginning	8	350
Glass and Ceramics	5	260
Healthcare	68	578
Information Technology	367	2,947
Insurance	11	284
Jute	-	20
Leather and Tanning	16	368
Lodging	22	462
Miscellaneous	324	5,937
Mining and Quarrying	66	572
Paper and Board	87	1,142
Pharmaceuticals	128	1,390
Power Generation	125	858
Real Estate Development	99	1,319
Services	520	7,182
Sport goods	12	199
Steel and Allied	23	508
Sugar and Allied	10	180
Synthetic and Rayon	3	194
Textile	141	4,662

⁶⁸ Data got from the Annual Report of SECP 2014,
http://www.secp.gov.pk/annualreport/2014/AnnualReport_2014.pdf accessed 12 July 2014

Tobacco	4	86
Tourism	421	6,706
Trading	544	7,310
Transport	99	1,286
Vanaspati and Allied	23	453
Woolen and Wood Products	11	215
Total	4,587	64,067

7.3.2 The Impact of Institutional Investment

A viable CG framework facilitates and encourages not only to local investors but also attracts foreign investments,⁶⁹ and foreign investors not just benefit local companies, they additionally contribute in the financial development of a state.⁷⁰

Foreign investment can be in the form of foreign direct investment (FDI) or foreign portfolio investment (FPI). In FDI, a foreign investor or company contributes by purchasing a standing company or establish a subsidiary company in the investee jurisdiction. However, in FPI, a foreign investor or company purchases shares in the investee company of the investee jurisdiction. Such trading has considerable impact on the CG structures of the host jurisdiction.⁷¹

FDI is usually takes place by a private or a public listed company (PLC). If FDI is via setting up a private subsidiary company then the governance structure of the investee jurisdiction might have least impact as the subsidiary company might adopt the governance standards of the investee jurisdiction where its holding company is registered.⁷²

⁶⁹ OECD, 'Foreign Direct Investment for Development: Maximising Benefits, Minimising Costs' <<http://www.oecd.org/investment/investmentfordevelopment/1959815.pdf>> accessed 20 July 2015

⁷⁰ Ruth Aguilera and Alvaro Ceurvo-Cazurra, 'Codes of Good Governance Worldwide: What is the Trigger?' (2004) 25(3) Organisation Studies 417

⁷¹ Itay Goldstein and Assaf Razin, 'Foreign Direct Investment vs. Foreign Portfolio Investment' (2005) NBER Working Paper Series <<http://www.nber.org/papers/w11047.pdf>> accessed 10 January 2016

⁷² Ibid

On the other hand, if FDI is through setting up a PLC then the governance framework of the investee jurisdiction will bear significant impact for the subsidiary company as the public companies are bound to follow the governance standards of investee jurisdiction. In Pakistan, FDI via PLC is prevalent,⁷³ and those companies are mainly from the UK and the USA, and hence can set standards for the local companies regarding the adoption and implementation of good CG norms.

Similarly in case of FPI, foreign investors might have serious concern with respect to the CG standards in the investee jurisdiction. This is because the foreign investor does not usually have direct link and impact on administration and is only concerned about getting maximum profits on their venture.⁷⁴ This practice shows that foreign investors normally make their investments, if they are sure about the security and the potential profits of their investments.

Therefore, the foreign investment will take place only if the host jurisdiction is a safe place for investment regarding good CG practices and the internal security. However, the security situation in Pakistan has been worse since the 9/11 attacks in the US. The FDI and FPI declined considerably in Pakistan⁷⁵ after the 9/11 occurrences and consequent war against terrorism in Pakistan.⁷⁶

The researcher submits that, the security situation and bad CG both are serious issues of Pakistan. The NandiPur Power Project (NPP) is the recent example of one of the largest CG failure as presented in section 1.2.1. Although the security situation is getting better since a couple of months however, the issue of bad governance is still there which requires serious attention in order to provide protection and attract not only to foreign investors but to local investors as well.

⁷³ According to the Santander Trade Portal, <<https://en.santandertrade.com/establish-overseas/pakistan/investing>> accessed 20 July 2015

⁷⁴ Imran Chaudhry *et al.*, 'Factors Effecting Portfolio Investment In Pakistan: Evidence From Times Series Analysis' (2014) 52(2) Pakistan Economic and Social Review 141

⁷⁵ Junaid Ahmed and Inmaculada Martinez-Zarzoso, 'Blessing or Curse: The Stabilising Role of Remittances, Foreign Aid and FDI to Pakistan' (2013) Discussion Paper, Centre for European Governance and Economic Development Research No. 153
<<http://econpapers.repec.org/papers/zbwcegedp/153.htm>> accessed 15 May 2015

⁷⁶ See table 7.3

Table 7.3: Foreign Portfolio Investment (FPI) in Pakistan during 1996-2014⁷⁷

Sr. No.	Year	US \$ million
1	1996	205.2
2	1997	267.4
3	1998	221.3
4	1999	27.3
5	2000	73.5
6	2001	140.4
7	2002	10.1
8	2003	22.1
9	2004	27.7
10	2005	152.6
11	2006	351.5
12	2007	1,820.4
13	2008	19.3
14	2009	510.3
15	2010	587.9
16	2011	364.6
17	2012	60
18	2013	119.6
19	2014	600

Table 7.3 above shows that, FPI declined after the happening of 9/11 attacks and as a result of them the war against terrorism in Pakistan. In 2007, the FPI increased due to the announcement of general elections but the terrorist attack on a political leader Benazir Bhutto seriously questioned the security situation which had an adverse effect on FPI. Additionally, the military takeover in 1999 was another key reason for the decline of FPI in subsequent years.

⁷⁷ Data is collected from the website of State Bank of Pakistan <<http://www.sbp.org.pk/>>, <http://www.sbp.org.pk/departments/stats/PakEconomy_HandBook/Chap-7.10.pdf> and <www.sbp.org.pk/ecodata/NetinflowSummary.pdf> accessed 15 July 2014

Table 7.4: Foreign Companies in Pakistan as on 30 June 2014⁷⁸

Country	Newly incorporated companies FY 213-14	Number of Companies as of June 30, 2014
US	1	156
UK	2	119
France	1	26
Germany	2	25
China	7	45
Japan	1	38
Australia	0	20
Middle Eastern Countries	2	62
Far Eastern Countries	4	119
Other European Countries	2	130
Other Asian Countries	0	14
Other Countries	0	93
Total	22	847

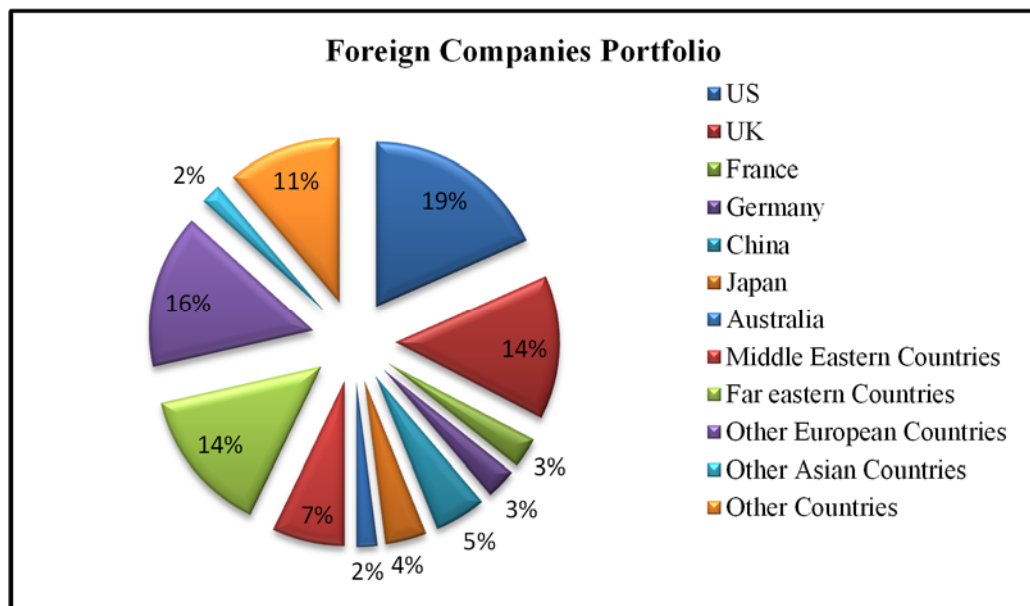


Figure 7.4: Total Number of Foreign Companies in Pakistan as on 30 June 2014⁷⁹

⁷⁸ Data taken from the annual report of the Securities and Exchange Commission of Pakistan

⁷⁹ Data taken from the annual report of the Securities and Commission of Pakistan 2014

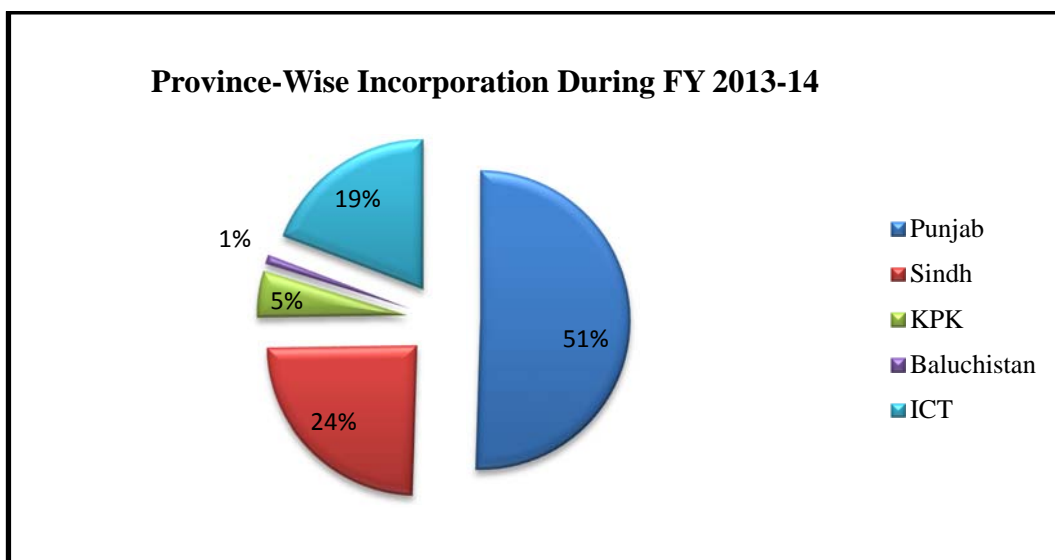


Figure 7.5: Province Wise New Incorporation during FY 2013-14⁸⁰

Table 7.4 and the graphs 7.1 and 7.2 show that, the number of foreign companies operating in Pakistan is mainly from the UK and the US as mentioned earlier. Such companies can play a significant role in setting the standards of good CG. IIs can also play their part in influencing their investee companies and to the government for the adoption and implementation of CG norms for the protection of shareholders' interest. As the investor, whether local or foreign prefer to invest when he is assured about the security of his investment and potential benefits.

7.4 The Driving Forces Behind the Activism of Institutional Investors

This section examines the driving forces behind the activism of IIs in the UK. It is important to investigate them here to find out similarities among the objectives and incentives of IIs working in Pakistan, as well as to formulate recommendations and explore new ways by which the activism of IIs can be enhanced in Pakistan and they can contribute to improve the CG of their investee companies' significantly.

⁸⁰ Ibid

The Cadbury Report emphasised on IIs that they can be instrumental to develop CG standards due to their large shareholdings and, therefore they are capable to have impact on the affairs of companies.⁸¹ This view was ratified by the Hampel Report which stated that: 60 per-cent of shares in listed UK companies are held by UK institution.⁸²

The later governance reports have also highlighted the importance of IIs and recommended for them to leave their indifferent attitude and play a significant role in influencing the governance structures of their investee companies. Though, the involvement of IIs in their investee companies' matters will be enhanced if they consider themselves as owners of investments instead of just considering themselves investment vehicle.⁸³

Charkham⁸⁴ contended that since various institutions consider shares as wares with no natural potentials instead considering that they can be promptly tradable in a dynamic business sector. IIs have liability towards the owners of the funds in which they finance. For example, the managers of pension funds have a fiduciary association with the owners of pension fund, and should act to their greatest advantage.

Likewise, insurance companies have obligation and therefore answerable to their shareholders. Therefore, IIs are bound to maximise the profits on their investment. In their part as real shareholders, both the Cadbury and Hampel Reports anticipated that institutions would tackle the part of the vast shareholders, who

⁸¹ Cadbury Sir Adrian, *Report of the Committee on the Financial Aspects of Corporate Governance* (Gee and Co. Ltd. London 1992)

⁸² Hampel Report, *Committee on Corporate Governance: Final Report*: (Gee: London) Para 5.1

⁸³ Ibid (n 5); John Hendry *et al.*, 'Responsible Ownership, Shareholder Value and the New Shareholder Activism' (2004) Working Paper No. 297
<http://www.cbr.cam.ac.uk/fileadmin/user_upload/centre-for-business-research/downloads/working-papers/wp297.pdf> accessed 10 May 2016

⁸⁴ Jonathan Charkham, *Keeping Good Company – A Study of Corporate Governance in Five Countries* ('required reading' Sir Adrian Cadbury, Oxford University Press 1994) 20; Jonathan Charkham, 'A Larger Role of Institutional Investors' in Nicholas Dimsdale and Martha Prevezer (eds), *Capital Markets and Corporate Governance* (Clarendon Press 1994a) "See generally"

will influence the company management by monitoring their actions for the benefit of minority shareholders.⁸⁵

Therefore, it is relied upon IIs to consider about their shareholding positions in long-term, and where required, bear cost of intervention to correct maladministration. Nevertheless, IIs should be allowed to transfer funds with a specific end goal to locate the best return for the recipients of those assets. However, it is challenging, surely in a free market environment, to contend that IIs ought to keep on holding equity positions in respective companies and bring about conventional cost interceding in administration, especially in the absence of any assurance that intervention will be effective.⁸⁶

Drucker⁸⁷ contended that: the pension funds are investors not owners; who invest the beneficiaries' funds in the most beneficial venture. In the event that they do not like or trust a company or its administration, their obligation is to sell and transfer funds. On the other hand, Hutton⁸⁸ contended that, insurance companies and pension funds have gotten to be great truant proprietors, applying influence without obligation and making demanding requests upon companies without perceiving their equal commitment as owners.

However, as shareholders, IIs have right to hire directors and their responsibility is to monitor that companies are being administered in the benefits of shareholders. Furthermore, shareholders are confronted with a potential free-rider issue. For instance, if an II took unreasonable activities to mediate in company affairs whilst other IIs just did nothing, the interceding II would have fewer profits which will be a disadvantage for their clients, at least in the short term. Therefore,

⁸⁵ Janice Dean, *Directing Public Companies: Company Law and the Stakeholder Society* (Cavendish Publishing 2001) 35

⁸⁶ Ibid (n 5); Edward Rock, 'Institutional Investors in Corporate Governance' (2015) Faculty Scholarship Paper 1458

<http://scholarship.law.upenn.edu/cgi/viewcontent.cgi?article=2459&context=faculty_scholarship> accessed 10 May 2016

⁸⁷ Peter Drucker, *The Unseen Revolution: How Pension Fund Socialism Came to America* (Heinemann: London 1976) "See generally"; ibid (n 5)

⁸⁸ Will Hutton, *The State We're In* (Jonathan Cape: London 1995) "See generally"; ibid (n 5)

it is challenging to evaluate what motivations and driving forces there are for IIs to tolerate a private price for the benefit of all.⁸⁹

Hence, the ultimate public good issue emerges due to the reason that individual IIs do not have adequate motivations to interfere in the management of companies. However, the diverse sorts of IIs might have different timeframes for investment. For instance, pension funds which ought to have a long-term view because of the way of their business would be expected to emphasise the significance of getting long-term corporate outcome.⁹⁰

Charkham⁹¹ presented two differentiating positions of active institutional investing, relating to the investment conduct of IIs which he named type A and Type B. These types represent the inverse closures of the investment range on which all IIs can be positioned. The contrasting qualities of Type A and Type B investors regarding to their investment strategies are presented in Table 7.5 below.

Table 7.5: Charkham's Conflicting Stances of IIs Conduct⁹²

Qualities	Type A	Type B
Portfolio make-up	Focus on less shares	Wide modification
Incentives in Companies	Large	Small
Communication with firms	Close	Superficial
Loyalty to companies	High	Virtually non-existent
Dealing activity	Less dealings	Frequent dealing
Interest in CG issues	High	Virtually non-existent

This Table presents, a Type A fund manager focus on the long-term outcomes of a comparatively small portfolio of companies. On the other hand, Type B fund managers emphasise the short-term returns of a comparatively large portfolio of

⁸⁹ Ibid (n 42); Jim Ball, *Financial Institutions and their Role as Shareholders Creative Tension?* (National Association of Pension Funds: London 1990) "See generally"

⁹⁰ Ibid (n 42); Mara Faccio and Ameziane Lasfer, 'Do Occupational Pension Funds Monitor Companies in which they Hold Large Stakes' (2000) 6 *Journal of Corporate Finance* 71

⁹¹ Jonathan Charkham, 'A Larger Role of Institutional Investors' in Nicholas Dimsdale and Martha Prevezer (eds), *Capital Markets and Corporate Governance* (Clarendon Press: Oxford 1994a) "See generally"

⁹² Adapted from Helen Short and Kevin Keasey

companies. Charkham suggested that the type of approach adopted by a particular II is dependent not only on the purpose of the investment, but also on a complex mixture of factors relating to the management of those funds, such as the motivation and ability of the individual fund managers.

The types of investment strategies depend on the approach of fund manager towards active investing. However, an increase in inactive investment through institutions has been noticed in the form of index-matched funds. The index-matched funds have a buy and hold policy; they ought to be keen towards longer-term investments. Although long-term investment policies does not as a matter of course prompt expanded monitoring and interference.⁹³

However, the intervention may increase the outcomes of companies and likewise the profit on the index as a whole, it is again hard to decide what motivations individual II would have to intervene.⁹⁴ Monitoring and involvement raises management expenses for their individual II, whilst it increases the outcomes of non-intervening investors as well.

As a result, the intervening II bears greater costs whilst other investors enjoy greater profits at lower cost. In such situation, the costs cannot be even transferred to the actual owners as they might then prefer to move towards lower cost investors. This highlights the crux of problem: IIs are not the actual owners of the funds and therefore do not share in the enlarged profits achieved through intervention, while they have to bear the cost of intervention alone. Unless there is collective interference by all IIs, the costs of intervention decreases the profit of individual II.⁹⁵

However, while investigating the aims of IIs, the general investment environment needs to be considered. Though, regardless of the way that the nature of business sector would appear to demoralise monitoring, there are several instances of IIs intervention in the administration of respective companies. For example, in 2003,

⁹³ Ibid (n 5, 42 & 90)

⁹⁴ Ibid (n 5, 42 & 90)

⁹⁵ Ibid (n 5, 42 & 90)

investors at Glaxo Smith Kline voted in order to reject its payment report regarding the remuneration package of its CEO, put pressure on the company to review its remuneration strategy.⁹⁶

Another example of shareholders involvement includes the dismissal of Sir Philip Watts as chairman of Shell in March 2004 and the dismissal of Peter Davis as CEO of Sainsbury's in June 2004.⁹⁷

In addition, the publication of the Higgs Report in 2003 led to a rather public breakdown in relations between the IIs and the executives of large companies.⁹⁸ However, Black and Coffee⁹⁹ noted that, the majority of involvement is normally done through private negotiations instead of doing publicly, moreover, commonly as a last option in serious situations.

To summarise, it is evident that the endeavour to combine the part of IIs as owners of the funds as well as investors is problematic. However, the objective of IIs should attempt to improve the CG standards and the performance of their investee companies.

7.5 The Factors Limiting the Activism of Institutional Investors

The IIs normally prefer to sell their shares from a problem company instead of intervening and monitoring the management of that company. In other words they choose 'exit' instead of making use of 'voice'.¹⁰⁰ Their stance behind such act is that, if they intervene publicly, they are disclosing openly the mismanagement and governance problems of that company. Such acts can result into the reduction in share value which ultimately will have bad impact on their investment.

⁹⁶ Ibid (n 5, 42)

⁹⁷ Ibid (n 5, 42)

⁹⁸ Derek Higgs, *Review of the Role and Effectiveness of Non-Executive Directors* (DTI London 2003)

⁹⁹ Bernard Black and John Coffee, 'Hail Britannia?: Institutional Investor Behaviour Under Limited Regulation' (1994) 92(7) Michigan Law Review 1997

¹⁰⁰ Albert Hirschman, *Exit, Voice and Loyalty: Responses to Decline in Firms, Organisations and States* (Harvard University Press 1970) 44

Additionally, if they are engaged in the administration of such companies they get to be aware of internal information and it becomes difficult for them to exchange their shares, possibly aggravating their damages. Moreover, appropriate monitoring and intervention is expensive (as discussed above also) in terms of time and money, particularly for IIs with diverse portfolios.¹⁰¹

In order to address these problems that IIs are facing, Hampel¹⁰² proposed that the choice of departing turns out to be more difficult as IIs build their interests in public companies, adopt index tracking policies and as the quantity of institutional players in the business sector drops. Trading vast shareholdings in a problematic company is prone to be greatly troublesome, especially as the probable purchaser is liable to be an option institution with knowledge of the potential issues prevalent in the company.

Nevertheless, Myners¹⁰³ points out that, even in situations where large institutions are not able to transfer their shares without any impact of share value; many indicated a market unwillingness to interfere in circumstances where companies were obviously facing problems.

It has been noticed that, because of the framework of the fund management course of action of professional IIs, agency issues emerge at each level in the association between the actual beneficiaries of the IIs. The technique and timing of the performance capacity of the fund and of the fund manager have a significant impact on the motivations of fund manager, and might expand agency issues between the parties.¹⁰⁴

Conflict of interest might emerge between the staff and the company, especially if the agents are also directors of the company, as frequently seen particularly in Pakistan. Directors might prefer to maximise the share price to minimise the

¹⁰¹ Ibid

¹⁰² Hampel Sir Ronnie, *Committee on Corporate Governance: Final Report* (Gee: London 1998)

¹⁰³ Paul Myner, *Institutional Investment in the United Kingdom: A Review* (HM Treasury: London 2001) 90

¹⁰⁴ Tracie Woidtke, 'Agents Watching Agents?: Evidence From Pension Fund Ownership and Firm Value' (2002) 63 *Journal of Financial Economics* 99

company's involvements and potentially use any pension fund surplus to expand company returns. The Robert Maxwell issue and the demise of the Mirror Pension fund in the 1990s was a serious instance of the issues which might arise between shareholders and directors.¹⁰⁵ Therefore, investors are under extreme pressure to perform better in contrast to median fund, which is often argued to have the consequence of focusing fund managers' attention on their performance relative to their competitors, rather than on their absolute performance.

Whilst, informal mechanisms may be in place in order to give institutions motivations to monitor and intervene in governance matters (through private negotiations instead of public voice) of their investee companies.¹⁰⁶

Pound¹⁰⁷ talks about three unique hypotheses which might clarify the relationship between IIs and their incentives to intervene in CG of companies. The diagram below presents those hypotheses.

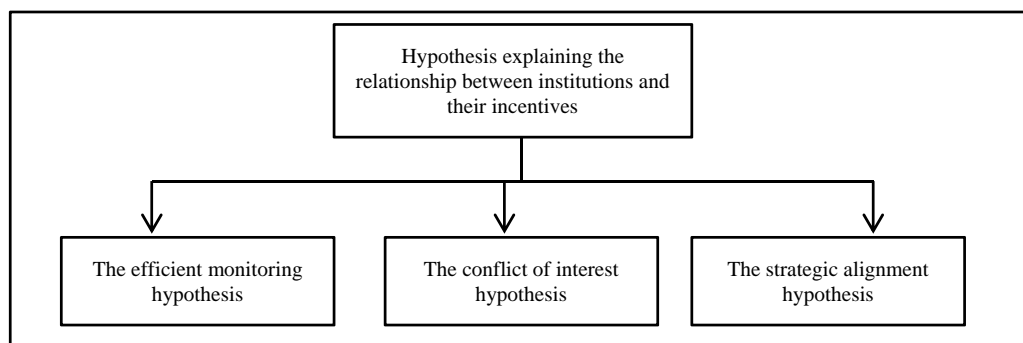


Figure 7.6: Pound's Hypotheses Which Explain the Relationship between IIs and their Incentives¹⁰⁸

The efficient monitoring hypothesis postulates that IIs are more experienced, educated and have capacity to monitor administration of their investee companies at reduced cost in contrast to minority or individual shareholders.

¹⁰⁵ Ibid (n 5)

¹⁰⁶ Ibid (n 5)

¹⁰⁷ John Pound, 'Proxy Contests and the Efficiency of Shareholder Oversight' (1988) 20 Journal of Financial Economics 237

¹⁰⁸ Developed by the researcher

On the other hand, the strategic alignment hypothesis proposes that IIs and the BODs might consider it jointly beneficial to collaborate on particular issues.

Similarly, the conflict of interest hypothesis advocates that IIs might have existing or prospective business connections with the company due to which they do not wish to actively curtail administration decision-making.

In short, IIs bear clashes of interests during their communications with companies as a consequence of their part as investor and present or possible business service provider, which potentially obstruct their inclination to involve in company's affairs in the occasion of CG scarcities. Additionally, it is evident that IIs themselves are not resistant from CG issues and might be criticising so as to unwilling to attract regard for these issues the companies in which they contribute. Moreover, another similar problem is the relationship between professional investors and their supporting companies which is liable to influence the way those investors perform towards other companies.¹⁰⁹

Therefore, agency problems might ascend between IIs and the actual owners of funds in situation if the II has motivations to maximise the long-term value of the fund however the performance of fund manager is assessed on a short-term basis, by virtue of quarterly trustees' meetings.

Likewise, institutional evidence presented to the Trade and Industry Committee on Competitiveness of UK Manufacturing Industry suggested that, whilst performance was monitored on a quarterly basis, performance was assessed over a longer period. In addition, a survey by CAPS found that,¹¹⁰ pension funds that changed their investment manager in 1993, the mean and median period of tenure of the outgoing manager was seven years. However, the Myners Review found that one-third of schemes had changed investment managers in 12 months prior to their survey.

¹⁰⁹ Ibid (n 107)

¹¹⁰ CAPS, *Pension Fund Investment Performance: General Report* (Combined Actuarial Performance Services Limited 1993) "See generally"

The obvious misunderstanding regarding the time period over which performance is evaluated led the Myners Review to conclude that fund managers could assume rationally that they could be dismissed after any quarter's performance, and that this could lead to managers being unwilling to take a long-term perspective.¹¹¹

The agency problems increased at the point when the remuneration granted to the fund manager is organised in a manner that in the occasion of the fund manager taking CG actions, s/he faces the expenses of intervention, however the actual owner picks up the profit. Fees are usually calculated on shares' market value, as the market value of shares rises, subject to a fixed minimum charge.¹¹²

Given that the funds under management are likely to spread across a large portfolio of companies, it seems unlikely that the benefits of monitoring and intervention to the fund manager in the form of increased fee income would exceed the costs. Coupled with the potential costs of lost business from the management of the offended companies,¹¹³ it would seem clear that there are few incentives for intervention at the level of the fund manager.¹¹⁴

This identifies the root of problem; IIs are not the actual owners of the shares and therefore do not significantly get their enhanced profits achieved from IIs involvement in company affairs. In this context, it can be concluded that a collective action is required to decrease the price of intervention and to enhance the profit of fund managers.¹¹⁵

Moving further, IIs have capacity to have a considerable control over the actions of BODs due to the size of their shareholdings in contrast to minority or individual shareholders. One aspect of the governance of companies is that the expenses of intervention should be less as compared to the potential advantages of

¹¹¹ Ibid (n 103)

¹¹² Robert Webb *et al.*, 'Problems and Limitations of Institutional Investor Participation in Corporate Governance' (2003) 11(1) *Corporate Governance: An International Review* 65

¹¹³ The fund manager may also be currently managing their pension funds or be a future contender.

¹¹⁴ Ibid (n 5) 73

¹¹⁵ Ibid (n 42)

intervention if governance activities are to be impacted.¹¹⁶ In this case, shareholders with large shareholdings have larger amount of motivations to be engaged in governance matters in contrast to smaller shareholders.

For example, individual shareholders having less shareholding have minimal motivating force to accumulate and bear the generally settled expenses of gathering data to empower them to supervise and control the conduct of BODs. On the other hand, large shareholders might have adequate motivations to access the information required to have an impact on management if the advantages of such monitoring are higher than the related expenses.¹¹⁷

Nevertheless, the control of management by large shareholders might incur expenses; if these shareholders are restricted relating to their divergence, and might have clashes with small shareholders. The influential shareholders and managers might co-operate in terms of diversion of resources from other shareholders.¹¹⁸ However, it would still appear to be a bold step to conclude about the percentage of shareholding, for example that shareholding of even 5-6% would be sufficient to affect the actions of corporations.¹¹⁹

Its are large as measured by any yardstick. For example, the Prudential had a market value of £9,654 million in June 2004, placing it in the top 30 companies listed on the London Stock Exchange (LSE) in terms of market value. Hermes¹²⁰ alone has approximately £44 billion in funds under its control, as at December 2003. This gives them a voice, via their impact upon the media, of considerable volume and a potential ability to influence general perceptions through which Hermes have used successfully in CG matters for the past decade. For example, in June 1994, Hermes instigated a campaign against directors' rolling contracts of

¹¹⁶ Satchell SE and Damant DC, 'Testing the Short Termism in the UK Stock Market: A Comment' (1995) 105(432) *Economic Journal* 1218

¹¹⁷ Joseph Stiglitz, 'Credit Markets and the Control of Capital' (1985) 17(2) *Journal of Money, Credit and Banking* 133

¹¹⁸ *Ibid*

¹¹⁹ *Ibid* (n 5) 74

¹²⁰ Which manages the BT and Post Office pension schemes

longer than three years by taking the then highly unusual step of writing publicly to the chairman of the top 100 companies.¹²¹

The ultimate advantages to be achieved by companies and IIs in ensuring their influence are in the private rather than the public domain because of which it is difficult to measure the influence of IIs. Therefore, it can be suggested that the large IIs can be able to influence the affairs of companies far beyond their minimal shareholdings. This then moves us on to consider why IIs bother to monitor the affairs of individual companies when they can free ride on the actions of others. The lack of governance by IIs due to the idea of getting advantages at the expense of individual II is responsible for a free-rider issue.¹²²

Since the advantages of combined efforts benefit to every individual regardless of whether that individual has endured any of the expenses of the combined action. It infers that, the combined benefit can be given by the business sector framework only if the group is small and fulfils some other particular conditions. By assuming that IIs are subject to such free-rider issue, it would be more important to look at why IIs ever participate in collective action when there are such a large number of components representing a mark against such activities.¹²³

For example, the non-appearance of a commonly acknowledged system for cost sharing among IIs that embrace collective action displays a noteworthy snag to such collective action. To some extent, the nature of the conflict which may lie between private and collective benefits/costs is correspondent to that of the Prisoners' Dilemma. Nonetheless, there are significant contrasts between the

¹²¹ Ibid (n 117) 35

¹²² Ibid (n 42); Joseph Yockey, 'On the Role and Regulation of Private Negotiations in Governance' (2010) 61 South Carolina Law Review 171; Willard Carleton *et al.*, 'The Influence of Institutions on Corporate Governance through Private Negotiations: Evidence From TIAA-CREF' (1998) 53(4) The Journal of Finance 1335, 1345

¹²³ Ibid (n 5, 42, 122)

Prisoners' Dilemma and the system inside of which IIs operate which might beat the apparently unconquerable free-rider problems confronting IIs.¹²⁴

7.6 Strategies of IIs to Influence the Management of their Investee Companies

The preceding sections have identified the absence of motivations for IIs in order to monitor and intervene in the management of their investee companies. Helen Short and Kevin Keasey explored the five ways through which IIs can exert a considerable impact and can intervene in the management of their investee companies.¹²⁵

The first strategy available for IIs is to decline to share in rights issues when companies go to the market to increase extra value funding. IIs are highly influential in these circumstances, due to the fact that the burden is on management to negotiate with the IIs. IIs might make the procurement of extra finance conditional to the changes in the management of company, such as, changes in the BODs. Since the companies are asking IIs to bolster them at the time of the rights issues, numerous issues of organising combined efforts will not emerge; especially the expenses of these efforts will be less for IIs because of the fact that they do not need to start such activity by themselves.¹²⁶

The second way available to IIs is negative opinion of public, which might harm the company by reducing its share value and reputation. However, this type of action also effect negatively to IIs along with the company. For example, Hermes in 1994, publicly criticised some companies' executive compensation contracts, it did not receive the warmest response from the companies concerned or from other institutions. Moreover, the association with the company is also important, as the II requires continuous backing of the company in order to access company's

¹²⁴ Ibid (n 42, 99); Stuart Gillan and Laura Starks, 'Corporate Governance Proposals and Shareholder Activism: The Role of Institutional Investors' (2000) 57 *Journal of Financial Economics* 275

¹²⁵ Helen Short and Kevin Keasey, 'Institutional Shareholders and Corporate Governance in the UK' in Kevin Keasey, Steve Thompson and Mike Wright (eds), *Corporate Governance Accountability, Enterprise and International Comparisons* (John Wiley & Sons Ltd. 2005) 80

¹²⁶ Ibid

internal information. Therefore, the IIs might favour private negotiations; as the relationship of company and II does not effect in this manner. If private negotiations work it is beneficial for parties, the IIs and the company, as it circumvents the expenses of extra volatility.¹²⁷

The third strategy IIs can adopt is the dismissal of directors through direct and collective action. This is an extremely rare course of action: the removal of Maurice Saatchi from this post as the director of Saatchi and Saatchi in 1994 and the prevention of Michael Green from taking the role of chairman on ITV PLC in 2003 are not the norm and occur only in extreme cases when it is clear that the usual ‘behind the scenes’ negotiations do not work.¹²⁸

The fourth way is a threat of selling a company’s shares or in other words, using the option of ‘exit’ rather ‘voice’ is another way to influence investee company but this action results into damage upon share price and general reputations of not only the concerned company but to the IIs as well. Therefore, this course of action cannot be used frequently, rather can be saved as a last weapon when other soft strategies do not work.¹²⁹

The fifth and most effective action available to IIs in order to utilise their right of voting at a company’s AGM. The ISC proposed that IIs should utilise their right to vote affirmatively and regularly. Moreover, the Cadbury Report¹³⁰ specified that; voting rights can be viewed as a benefit and the utilisation of generally of those rights by IIs should be genuinely considered by beneficiaries on whose behalf IIs invest. We suggest that IIs should reveal their strategies regarding the use of voting rights.¹³¹

The later committees have given more prominent emphasis on the significance of institutional voting than Cadbury. Additionally, an apparent advantage of compulsory voting is that the costs of keeping up exceptionally expanded

¹²⁷ Ibid (n 125) 81

¹²⁸ Ibid (n 125) 81

¹²⁹ Ibid (n 125) 81

¹³⁰ The Cadbury Report (1992) Para 6.12

¹³¹ Ibid (n 125) 81

portfolios would escalate, possibly compelling investors to alter their investment strategies. Given that the expenses of voting will, in any case, contrast between various sorts of investment strategies, it is expected that, the pension funds will be directed into lower-cost measures; predominantly collective funds whilst still keep up profoundly differentiated portfolios.¹³²

From this time forward, whilst the presentation of lawful commitments for pension funds to practice their voting rights might initially appear an appealing choice, it is unrealistic to deliver the required advantages of improved monitoring. Given that IIs wish to practice any control they consider essential in private, the introduction of mandatory voting might just prompt ‘lip service’ being paid to the voting procedures, with no progressions to the basic attitude of investment and ownership approach.

Moreover, because of compulsory voting, IIs might essentially fall back on ‘box-ticking’ due to individual company’s request of the Combined Code, instead of submitting to the ‘comply or explain’ philosophy which strengthens the CG proposals in the Combined Code, prompting companies to follow the CCG, irrespective of whether its proposals give the ideal governance mechanism to individual company.

7.7 Importance of the Legal Environment for Institutional Investors

A legal environment of a specific state significantly impacts the degree of action with respect to shareholders. The IIs are active in the UK, due to the fact that the state has adopted solid legal actions to reinforce the CG norms. For example, the Cadbury,¹³³ Greenbury,¹³⁴ Hampel¹³⁵ and Higgs Report¹³⁶ mentioned objective facts with respect to the characterised part of IIs in promoting CG norms. Likewise the ‘Combined Code (the Code)’¹³⁷ particularly joined a different

¹³² Ibid (n 125) 81

¹³³ The Cadbury Report 1992

¹³⁴ The Greenbury Report 1995

¹³⁵ The Hampel Report 1998

¹³⁶ The Higgs Report 2003

¹³⁷ The Combined Code of Corporate Governance of the UK 2003

portion entitled ‘Institutional Investors’ in which the fundamental rule set down is that the IIs ought to go into a dialogue with companies in light of the common apprehension of end goals.¹³⁸ This implies that the Code encourages IIs to have negotiations with their investee companies in order to point out the matters of their concern.

The Code clearly explains the responsibilities and authorities of IIs in the execution of CG standards. The Code requires from IIs to significantly use their voting rights.¹³⁹ It is obligatory for IIs to appear in AGMs of their investee companies. Additionally, they are also bound to give considerable attention to all significant and relevant issues comes to their consideration at the time of assessing companies’ governance course of action; specifically involving the structure and composition of BODs.¹⁴⁰

The researcher submits that, these provisions of the Code reveals an interesting and encouraging fact that, the strategies (examined in section 7.6 above) which IIs were/are using to influence their investee companies are made the part of CCG in the UK. Thus, the Code fulfils the dual purpose; on one hand, it gives the power to IIs to intervene in the affairs of their investee companies and influence their strategies towards better CG standards and; on the other hand, it set the liabilities of IIs and bound them to perform their duties towards setting good CG standards and hence, creates an equilibrium of powers on both sides; the IIs and the companies.

Such type of legislation is also required for the IIs working in Pakistan’s corporate sector, as the situation in Pakistan different. The principal laws directing the relationship of shareholders and their investee companies are the Companies Ordinance 1984, the Securities and Exchange Ordinance 1969, the listed Companies (Substantial Acquisition of Voting shares and Takeovers) Ordinance

¹³⁸ Rule E1 of section 2 of the Combined Code 2003,
<http://www.ecgi.org/codes/documents/combined_code_final.pdf> accessed 20 July 2015

¹³⁹ Rule E3 of section 2 of the Combined Code 2003.

¹⁴⁰ Rule E2 of the section 3 of the Combined Code 2003.

2002 and the CCG of Pakistan. But sadly, these legislations do not contain any clear provision relating to the powers, roles and responsibilities of IIs.

This thesis conducted a thorough investigation of the CCG of Pakistan (in chapter four) but did not find any provision relating to the role of IIs. It seems that the authorities and regulators in Pakistan has not yet acknowledged the existence and importance of IIs in corporate sector, otherwise they should have set out an appropriate legislation in order to define and organise their role.

The economy of Pakistan is unstable because of political instability, security concerns due to war against terrorism, energy crises, corruption and many other factors; as a result of which the capital market of Pakistan is excessively-depressed and underdeveloped. Therefore the need for local and foreign investment is highly required for the growth of capital market. IIs being generally professional, experienced, and skilled and having large shareholdings can help to produce positive modifications and impact on the capital market of Pakistan.

For this purpose, efforts are required from both sides; the regulators (State, SECP, PICG) should give due consideration to the importance of IIs and take measures to enhance their role in the CG of the country by formulating a legislation along the lines of the Combined Code of the UK, which should define the powers, liabilities, roles and responsibilities of IIs towards their investee companies. Secondly, the local IIs should also play their part in it and organise themselves with mutual considerations. For this purpose, they can make efforts to establish a platform in the form of 'ISC' as working in the UK or 'the Council of Institutional Investors' working in USA with the help of SECP.

7.8 Recommendations to Enhance the Part of IIs towards their Investee Companies

As examined in the current chapter and in previous chapters, CG in Pakistan is still in its developing stage, and the part of IIs in CG has not been recognised fully. However, the above data shows a considerable rise in the local and foreign portfolio investment in Pakistan. One of the biggest hurdles for II's particularly

for foreign investors was the security situation, which is much better now than a couple of previous years due to the undergoing operation (Zarb-e-Azb) of the army against terrorists.

Above data shows a considerable scope for IIs (for both local and foreign in the form of FDI and FPI) in Pakistan. This thesis argues that, IIs can assume a vital part in the CG of Pakistan through adopting the measures as specified in the UK Code¹⁴¹ (those measures are presented below); however, the introduction of a strong legal measures along the lines of the UK Code for them are important in first instance as mentioned above.

7.8.1 Private Negotiations

The IIs should have a dialogue with their investee companies through informal meetings and negotiations as usually done in the UK and the UK Code also encourages this practices.¹⁴² Major contentions can be overcome via mutual discussion and negotiation. This practice serves two folds objectives; it comes into the notice of companies' management about an issue IIs face or notice any irregularities on the part of BODs which can be resolved behind the doors with mutual consent, and secondly IIs do not have to adopt open practices in the form of 'exit' and thus companies' reputation and share prices remain stable.

The CCG of Pakistan does not contain any of such provisions encouraging or empowering the IIs to intervene in the investee companies' matters through negotiations. Hence, the CCG of Pakistan ought to explicitly introduce such provision which could provide a particular means to IIs to resolve their issues through negotiations instead of taking severe public actions and seeking legal remedies, which damage the performance and reputation of both parties. The IIs might be angry due to any specific action of the BODs, unnecessary remuneration of the directors, unjustified favour to few investors or absence of transparency, accountability and disclosure strategies. To resolve each of these issues, a

¹⁴¹ The Combined Code of Corporate Governance of the UK.

¹⁴² Section 2 Rule E1 of the UK Combined Code 2003

<http://www.ecgi.org/codes/documents/combined_code_final.pdf> accessed 20 August 2015

dialogue between IIs and their investee company can be proved a more reasonable alternative.

7.8.2 Shareholder Voting

IIs having large shareholdings can influence and change any adverse decision made by their investee company through using their voting powers effectively. Non-exercise of voting power by the large shareholders actually permits the management, to confer acts of neglect and serious abnormalities by making decisions inconsistent with the interests of shareholders’.

The UK Code¹⁴³ bound IIs to make a considerable use of their rights of vote in order to handle the malpractices of the management of their investee companies. However, the Pakistan’s CCG does not contain any such provision conferring responsibility upon IIs to use their voting powers effectively; in fact the Pakistan’s CCG does not speak anything about the roles and responsibilities of IIs (as has been discussed above too). Active involvement of IIs in the undertakings of their investee company can be anticipated only if wisdom of obligation to use their voting powers is produced through legislation.

7.8.3 Evaluation of Governance Disclosures

The IIs should give a due consideration to the matters especially relating to the structure, diversity and composition of BODs at the time of assessing companies’ governance measures. By doing this, IIs can evaluate the capabilities and independence of BODs of their investee companies, as the effective and independent corporate boards are pertinent for the better corporate and financial performance of companies. The IIs can exercise this activism by randomly examining the annual accounts, audit reports and the structure of BODs of their investee company.

Additionally, IIs ought to guarantee that the independent NEDs are demonstrating their actual objectives and their recommendations are included in the agenda of

¹⁴³ Rule E3 of section 2 of the Combined Code of Corporate Governance 2003 of the UK.

AGM of the company appropriately and have been given true consideration in order to resolve conflicting matters. An active supervision and the assessment of the performance of investee companies by IIs will point out the controversies and irregularities at a primary level and will help to expand the wealth of shareholders and safeguard their interests.

The regulators should take measures by introducing such provisions in the CCG of Pakistan in order to consider liability on IIs to regularly monitor and evaluate the governance practices and disclosures of their investee companies as is done in the Combined Code of the UK.¹⁴⁴

7.8.4 Establishment of Institutional Investors' Committee

The SECP should establish a committee for IIs along the lines of 'Council of Institutional Investors' working in the US and the 'Institutional Shareholders Committee' working in the UK. As, SECP established the PICG in order to create awareness among the business community about the advantages of adopting CG practices; the establishment of a committee for IIs will provide a platform to IIs working in Pakistan to discuss collectively the problems they face while making investments and monitoring the listed companies of Pakistan, and formulate policies for themselves to take collective action in order to influence their investee companies, it will also resolve a significant issue of cost involved in monitoring the companies when all institutions will strive to work together.

This platform will also provide opportunity to IIs to draw attention of policy makers and regulators to introduce a specific legislation providing the protection to the activities of IIs in Pakistan's corporate sector and define the powers, roles and responsibilities of IIs towards their investee companies and the companies towards their investing institutions. Moreover, this platform can also encourage and excite the inactive investors and could prompt them towards their active involvement in the affairs of the listed companies of Pakistan.

¹⁴⁴ Rule E2 of section 2 of the Combined Code of Corporate Governance 2003 of the UK.

7.8.5 Establishment of a Corporate Strategy Committee (CSC)

The recommendation to establish a CSC is already on table in Pakistan. The advocates of creating a CSC confers that, each listed company should establish its own CSC along the lines of China, by hiring local or foreign professionals, and their responsibility should be to conduct research on the existing corporate laws of the country, to examine their implementation ratio and evaluate their impact of the performance of company. The CSC should also be able to investigate the provisions of corporate laws relevant to their portfolio companies, identify their weaknesses and make proposals for their amendments.

This thesis argues that the idea of establishing a CSC seems interesting in terms of its functions, but the extra cost involved in its establishment and hiring professionals for this committee may not convince listed companies to take this measure and therefore, would not be practicable. However, if the SECP takes initiative to establish a CSC as an independent body (as PICG) which should operate on behalf of the whole corporate market collectively, it may prove more beneficial. Because there will be no extra cost on companies instead its establishment and hiring its professional will be the responsibility of SECP and SECP will bear its expenses getting approved by the federal government.

However, whether government will allow establishing such an independent institution or not is another issue of concern. Nevertheless, the research conducted by CSC and reports issued by it as Financial Reporting Council (FRC) does in the UK, can have a noteworthy impact on identifying the weaknesses of corporate laws of Pakistan, their restructuring and those laws, the adoption and implementation concerns regarding CCG by the business community and finally the impact of those laws and CCG on the performance of companies.

In conclusion, IIs can play a considerable part in the CG of their investee companies, if the policy makers and regulators take appropriate steps to promote and encourage them. For this purpose, the introduction of a proper legislation or the inclusion of provisions in the CCG is essential clearly defining the powers and functions of IIs (as discussed above in detail).

7.9 Conclusion

This chapter has examined the role of IIs in promoting CG principles in order to attain one of the objectives of this thesis. It conducted a thorough investigation regarding the origin and significance of IIs and the notion of their ‘activism’, what it entails and what is its impact on the investee companies of IIs generally as well as regarding Pakistan particularly. The current chapter has presented the data showing the patterns of shareholdings in the corporate sector of Pakistan and established the scope of IIs (both local and foreign) in the corporate sector of Pakistan.

This chapter also analysed and explored the incentives available to IIs that encourage them to assume their part actively in the CG of their investee companies. Additionally, the present chapter examined those factors which limit the activities of IIs and analysed the strategies which IIs utilise to influence their investee companies and intervene in their management. Lastly, this chapter made proposals for enhancing the role of IIs in Pakistan, so that they could play their part effectively in the CG of Pakistan.

CHAPTER EIGHT: CONCLUSION

8.1 Introduction

The previous chapters of this thesis present data analysis and discussion of findings to answer the research questions of this thesis. The aim of this chapter is to present a summary of the findings of this study. It presents a brief overview and recap of the aim and objectives of this study and presents the key findings of this study. This chapter further confirms the original contributions of this thesis and identifies its limitations as well. It also outlines prospects for future research. Lastly, this chapter finishes by providing the concluding remarks regarding this study.

8.2 Overview of this Study and its Findings

This study set out to explore the ways and measures which can help to improve and develop corporate governance (CG) in the listed companies of Pakistan. The reason for conducting this investigation is the considerably increasing importance of CG globally as established in the previous chapters of this thesis. This study established that the corporate sector of Pakistan is in a transition stage. The importance and dramatic benefits of adopting CG principles has not been fully acknowledged by the business community of Pakistan.

Therefore, this researcher wished to explore the ways to improve CG in the listed companies of Pakistan. To achieve this objective, the study sought to answer four questions presented below.

1. Why does the CCG important for companies and what could be the form of an effective and efficient CCG for the listed companies of Pakistan?

2. How does the implementation and enforcement of CCG be improved in the listed companies of Pakistan by reforming the enforcement mechanisms of Pakistan?
3. How do the BODs affect the CG of their companies and what could be the model of an effective corporate board for the listed companies of Pakistan?
4. What role institutional investors (IIs) can play in order to promote CG principles in the listed companies of Pakistan?

For this purpose, the research model consisted of four key variables explaining the influence and monitoring role of IIs and BODs in the CG of Pakistani listed companies is selected. The monitoring role has defined by board diversity, size, composition, roles and responsibilities and the effectiveness of BODs in improvement of company value.

The study showed that CG principles help to make corporate boards more responsible and accountable, increase shareholder confidence and attract capital, which leads to the better financial performance of companies and ultimately results in a boost to a country's economy. The influencing role was described by the recommendations to company, inducing changes in company strategy and execution of institutional power through IIs in order to improve CG in Pakistani listed companies. The influencing role also covered the updating of both 'law in books' and 'law in action'.

As we have seen, CG is usually refers to as a framework through which companies are managed and monitored. CG is the formal name of procedures through which shareholders' interests are protected, the goals of a business set out and achieved. It additionally deals with the roles, responsibilities and the link between BODs, shareholders and other stakeholders. This study found that there is a developing concern for the idea of CG in Pakistan chiefly on the grounds that CG is a key to adding to a business sector economy and common society in developing economics (section 1.2).

It is turning out to be progressively imperative to investors, due to the reason that companies having higher governance standards have less risks and unexpected incidents, this can ensure shareholders rights and give better affirmation that administration will act to the greatest advantage of the company and every one of its stakeholders. Numerous financial experts in Pakistan acknowledge that poor CG practices in the listed companies of Pakistan, such as the absence of appropriate disclosure, transparency and accountability in the business sector are the major causes responsible for declining investor confidence (the examples are provided in sections 2.4.2, 2.4.3, 5.3.). Therefore, the need for effective CG is undeniable for the purpose of rehabilitate investor confidence.

8.2.1 The Code of Corporate Governance (CCG) of Pakistan

The first question (objective) of this study was to establish the importance of CCG for companies and investigate that what could be the form of an effective and efficient CCG for the listed companies of Pakistan. Chapter four dealt with this by using an exploratory and interpretative qualitative approach. It discussed the framework of CG, the nature and development of CG in Pakistan and found that the legal environment in Pakistan is not healthy and supportive to let CG practices to flourish there. The CCG is outdated which contains ambiguous and overlapping provisions and do not cope with the contemporary needs of corporate sector.

The study conducted the analysis of the CCG and formulated a number of recommendations which are presented here briefly. Firstly, it is found that legal process is very slow in Pakistan as the first CCG was issued in 2002 and that CCG revised and issued again after ten years in 2012 which is not impressive and appropriate. The regulators should update CCG regularly every year or at least once in two years according to the changing needs of corporate sector of Pakistan, by observing the response of business community regarding previous CCG, by discussing with major stakeholders and by carefully considering the regulatory impact assessment (RIA).

This process will definitely improve the CG practices in Pakistan, as this continuous process will be conducted through identifying the weaknesses of preceding CCG and adding the new required principles of CG in it.

This study found that the provisions of CCG of Pakistan are mandatory in nature except two (section 4.4). This thesis criticised this in two ways: Firstly, many provisions of CCG overlaps with the provisions of the Companies Ordinance 1984 (identified in section 4.4), in this way the application of CCG becomes problematic as adoption of both (the CCG and the Ordinance) is mandatory; consequently, the business groups having vested interest expropriate such provisions and use them according to their benefits.

Secondly, one clause of CCG left voluntary is related to the selection of independent non-executive directors (INEDs) which requires the appointment of one INEDs compulsory however, the preference is given to appointing one third members of BODs as INEDs. This thesis argued that this provision should actually be mandatory with a modification and that is; the number of INEDs should be enhanced from one to fifty per cents of the members of BODs. This will improve CG practices by creating the system of check and balance and increasing the accountability and monitoring of BODs.

Moreover, the Securities and Exchange Commission of Pakistan (SECP) and Pakistan Institute of Corporate Governance (PICG) should formulate a strategy to enhance the awareness among public generally and business community particularly regarding two issues: one the benefits attached to adopt CCG and follow CG principles, and secondly the business community should realise that the office of INEDs is not merely an honorary office rather it is to make BODs more independent and create a system of check and balance in the internal structure of a company which ultimately enhance a company's performance, shareholders' wealth and promote CG practices.

Lastly, this thesis argued that these weaknesses and problems regarding the form and application of CCG can be reduced. Indeed it can be improved if the CCG could be revised and updated regularly as presented above. Therefore, this thesis

answered the first question of this study by establishing the importance of CCG for the performance of companies and the protection of shareholder interests and also presented recommendations to improve the form and substance of CCG of Pakistan.

8.2.2 The Implementation of CCG in Pakistan

The second question (objective) of this thesis was to investigate how the implementation and enforcement of CCG can be improved in the listed companies of Pakistan by reforming its enforcement mechanisms. This research question was formulated on a belief that ‘law in books’ only is not sufficient to reform a system, ‘law in action’ is also equally important. In fact the laws are those which can be enforced and could be seen in active position as established in chapter five, otherwise the existence of even best laws would have no use and cannot build a healthy legal environment, if they cannot be enforced.

Chapter five focused on this investigation relating to the improvement of the enforcement mechanism in Pakistan. This study found that it is the judiciary and capital market which can play their part in reforming the system and making the enforcement mechanism more effective. The security of investors cannot be ensured with simply the provisions of laws, instead the nature and value of enforcement also matters. The law is essential in the initial period of reforms yet enforcement of law must additionally be enhanced for improved CG and shareholders’ security.

This thesis argued that an efficient judicial system is required to achieve good CG in a specified framework. However, Pakistan’ judicial framework is not efficient enough, and remains unsuccessful in providing justice to the overall community (see section 1.2.1 and chapter five). The condition of judiciary is even worse with regards to issues that are special and technical in nature such as corporate matters. Dishonesty, unnecessary postponements in discarding cases, legal cost, absence/limited of expert judges in relevant matters and the inefficiency of the entire legal framework are the principal issues as discussed in section 5.4.2 of chapter five.

This thesis argued that, in order to resolve these judicial problems, reforming the whole judicial system would not be a good choice; as it would be protracted and expensive as well as would not tackle the issue of corporate matters as this will necessitate additional training of judges. Therefore, establishing separate specialised corporate courts can serve the purpose. The state has already officially settled various specific courts and tribunals in numerous fields and they are performing in superior way than general courts (see section 5.4.3).

Secondly, this thesis emphasised on the separation of judiciary from the influence of the Executive and challenged the 19th amendment of the Constitution of Pakistan 1973, according to which the powers of appointment and removal of the judges of superior courts have been transferred to the Parliament. This thesis argued that the political interference in the appointment and removal of higher officials in the key institutions of Pakistan such as judges of superior courts and the commissioners of the SECP should be curtailed in order to reform the system and enhance the independence of judicial and SECP.

The idea of establishing special corporate courts will serve the purpose only if the appointment of judges will not be political but rather based on merit. On the other hand, judges should also remain separate from politics and no judge should be allowed during or after their service to indulge in any political activity. This thesis argued that these measures should be considered seriously and implemented if the authorities really wish to reform judicial system of Pakistan, as the independence of judiciary is most important for the enforcement of laws in true sense.

The other important aspect regarding enforcement is Pakistan's capital market. This is not mature yet and is in developing stage (section 5.5). The market ignored to practice implementation of CCG. Section 5.3 identified the factors which are responsible for the unsuccessful implementation of CCG in Pakistan; among them the most important are the non-serious role of government (as established in section 1.2.1), and family owned businesses. In order to overcome this problem, this thesis recommended the phased implementation of CCG by dividing the capital market into three segments: such as primary, secondary and third market.

The primary market should require more disclosure and transparency in controlling related party transactions, International accounting standards (IAS) and mandatory compliance with the CCG. The secondary market may require less disclosure, transparency and voluntary compliance with the CCG. The third market should be for new, private and non-listed companies which will require only voluntary compliance with the CCG.

Multinational and large companies will be more inclined towards having listing on primary market due to their reputational apprehensions. This will likewise be valuable to small and scattered shareholders who wish to put resources into the primary market. The IIs might put resources into both markets as they can utilise their position and voting power to guarantee compliance even in secondary market and force their investee companies to get listed on primary market because of an environment of competition, which will be created automatically after the segregation of capital market.

The secondary market can be of interest for new and small companies and to family owned and other vested interest groups who do not like disclosure requirements, accountability, transparency and compliance with the CCG; when they get acquaintance and recognise the possible advantages of the primary market, they might enrol on this market.

This thesis argued that this division of market will create an environment of competition which will involve reputational concerns at its utmost importance; secondly this division will also help in creating awareness among business community regarding the potential benefits of CG practices and help to the PICG to accomplish its task, as the PICG was established for the purpose of creating awareness regarding the advantages of CG principles among general public and business community. The media, credit rating agencies and IIs can also play a significant role in this regard.

8.2.3 The Role and Effectiveness of BODs in Promoting CG Practices

The third question (objective) of this thesis was to investigate the role of BODs to find that how they affect the CG practices of their companies and to develop a 'Board Effectiveness Model' for the listed companies of Pakistan. Chapter six dealt with this. This thesis developed a Board Effectiveness Model for the listed companies of Pakistan on a belief that the BODs can play a considerable role in the improvement of CG in their companies, by adopting an exploratory and comparative approach analysing both theoretical and empirical impacts of earlier studies and by comparing them with the corporate boards of Pakistani companies.

The thesis found that the main role of BODs is to ensure performance of the company. This role consists of advice, strategy development, resource dependence, monitoring and accountability. However, to protect shareholders' interests, corporate boards must be effective and efficient as it adds value in the company's corporate and financial performance as established in chapter six. This thesis found that, the effective and efficient corporate board is influenced by various elements such as, its diversity, size and composition among others. These elements discussed and analysed in chapter six.

This study further found that BODs with diverse backgrounds rather than homogenous elite groups with similar socio-economic foundations, expands its impartiality and enhances monitoring of the activities of BODs. It acquires differing qualities thoughts, point of view, experience, and business knowledge in corporate boards. This can aid to handle the complexities of the corporate outside environment and marketplace in better way. It can likewise expand innovativeness and development in corporate boards because of differences in intellectual capacities, which will leads towards better decision-making.

Moreover, board diversity connects a company to its outer surroundings and protects basic assets, comprising expertise, business contacts, esteem and legality. A higher level of board assorted qualities might also give a positive signal to probable job candidates which will encourage and attract experienced and highly

qualified individuals to be a board member. This might also generate a fair competition in company's inner labour sector.

This thesis further found that the size of BODs is an important board attribute. Agency theory declares smaller corporate boards more worthy and effective in contrast to larger corporate boards in enhancing the performance of companies, which ultimately affect CG practices. Smaller corporate boards can improve and enhance their execution in terms of monitoring. However, larger corporate boards have a tendency to underline thoughtfulness, graciousness and courtesy in the meeting room at the detriment of truth and honesty.

The argument is that when the size of corporate boards turns out to be too large, agency issues are intensified and the board turns out to be more symbolic and disregards its controlling, managing and monitoring obligations. Another argument is that when the size of corporate board expands, the probability of financial statement deception increments, inferring the requirement for expanding monitoring with larger corporate boards. Another argument is that the larger boards incur extra expenses normally connected with the process of slow decision-making, which are greater as compared to a few minimal benefits from extreme monitoring of the acts of administration as established in chapter six.

Conversely, smaller boards will probably be strong and will have more operative and effective consultations. Therefore, the directors will be able to honestly contribute and express their point of views within the restricted time. Thus, limiting corporate board size can improve efficiency. This thesis argued that, although smaller boards are more effective and efficient than larger boards in the light of above arguments; the important issue is having a balance of skills, experience, expertise and independence in board.

Therefore, the size of a corporate board in listed companies should neither be too small that it becomes difficult to manage the company's affairs; nor it should be too large that it becomes an extra burden on company in terms of cost and time involved in taking strategic decisions of a company, as larger boards will obviously take longer time to reach a decision. However, this researcher did not

find any considerable problem in the listed companies of Pakistan in terms of size of their boards.

The range of their board's size was between 7 to 11 which is normal (section 6.3.2); however the existence of women on corporate boards of the listed companies of Pakistan was found very limited. The researcher argued that it is the clear violation of the CCG, as the clause (i) of the CCG of Pakistan requires corporate boards to be diverse having a balance of experience, skills and gender. This thesis has also established the importance of women on board (section 6.2.2) and recommended that the regulators should seriously consider making corporate boards gender balanced, as it makes boards more efficient, disciplined and focussed.

Moreover, this thesis found that the composition of BODs is also a significant factor which has considerable impact on the effectiveness and independence of BODs (section 6.4). The composition of BODs consists upon the number of NEDs as compared to the executive directors. The proponents of a large number of NEDs argue that the boards with majority of executive directors are less accountable therefore they may exploit company resources for their personal benefits. However, the advocates of having a large number of executive directors on BODs argue that NEDs can impact negatively on company outcomes, because they have less experience and knowledge regarding the core business as compared to the executive directors.

This thesis argued that increasing the number of INEDs on corporate boards makes the BODs more accountable by keeping an independent external eye on the policies of BODs, if the appointment process of NEDs is to be made fair and on merits. The more independent corporate boards can better protect the stakes of shareholders, can monitor and evaluate the performance of BODs and their strategic decision-making. Such practices ultimately promote the CG best practices in the country and increase the company performance as well.

Furthermore, this thesis proposed that, giving representation to IIs in BODs can also make corporate boards more effective and accountable. The IIs being

professionals and owning large shareholdings can have a better say to provide safeguards not only to shareholders but for all stakeholders' interests and such practices would lead to the better corporate and financial performance of companies. This assertion also leads and is closely linked to the final question of this study that is; what role IIs can play in improving CG practices in the listed companies of Pakistan.

8.2.4 The Role of Institutional Investors in Promoting CG Practices

The fourth question (objective) of this thesis was to explore the role of IIs in order to improve CG in the listed companies of Pakistan. Chapter seven dealt with this. This thesis established that IIs are growing significantly during the previous couple of years and are engaged in various features of the economy of countries (section 7.2). Therefore, the examination of this topic was necessary in order to determine their potential importance and influence in the contemporary corporate world. The objective was to examine their role in Pakistan's corporate sector and explore the measures through which they can contribute to improve the CG practices in the listed companies of Pakistan.

The study found that although IIs were not active and, indeed, remained passive in the corporate sector of Pakistan; their role is increasing there now. The mutual funds, investments companies, insurance companies and some other institutions are also working there (section 7.2). Though their role is limited, they have started to realise that there is a considerable scope for them in Pakistan's corporate sector being in a developing and transition stage. Currently, IIs are working with banks and multinational companies in Pakistan; even they have membership in the Bank's BODs as well (section 7.3).

This thesis argued that this role of IIs can be enhanced to other listed companies as well if a healthy and supportive legal environment is provided to them as they are working in the UK, the US, South Africa and in many other countries of the world. The guidance can be obtained in this regard from other developed countries particularly from the Combined Code of the UK where IIs are influential enough and contributing in that economy.

This study further explored the willingness and ability of IIs to intervene in the governance of companies and established that they can intercede in companies' governance matters in many ways; for example by refusing to participate in rights issues, by adverse public comments, by removing directors through their direct and collective action, by the threat of selling company's shares and through right of voting in the AGM. Furthermore, they can also negotiate with investee companies as this practice is also common among the IIs in the UK. These negotiations may fulfil a two-fold purpose, one management becomes aware of the issues and opinion of IIs on a particular point and secondly, these informal negotiations do not affect the company's reputation and ultimately the shares price remains stable.

Moreover, this thesis proposed that the establishment of Institutional Investors' Committee (IIC) along the lines of a 'Council of Institutional Investors' working in the US or 'Institutional Shareholders' Committee' working in the UK can also help in making IIs influential and increasing their role in the CG of the listed companies of Pakistan. The idea behind this is to provide a platform to IIs where they can share the problems they are facing in the corporate sector of Pakistan and discuss their strategies collectively to intervene in the company management in order to protect their clients' interests as well as to promote CG of their investee companies.

This thesis argued that, the active monitoring of the performance of a company by IIs is essential for their improved engagement, and it can be achieved only if a healthy working environment and strong platform is provided to IIs. The regulators should play their role in this by introducing such laws that can provide protection to IIs. IIs should also raise their voice in this regard and should strive to inaugurate such platform where they could meet and develop policies to work together. Such measures will not only enhance the growth of IIs in the corporate sector of Pakistan but also will increase the corporate and financial performance of companies and will also attract foreign investors which will prove a positive step for the country's economy.

Moreover, this thesis found that some corporate experts in Pakistan suggest that there should be a Corporate Strategy Committee (CSC) in Pakistan like china. The Clause 53 of CCG of China postulates the main duties of the CSC to conduct study and formulate proposals for the strategic growth ideas and key decisions of the company in terms of investments. The promoters of the establishment of CSC argue that, the establishment of CSC will improve the overall efficiency of companies.

The CSC can consist upon the senior members of the company. The professional researchers should also be appointed to conduct a research on existing corporate laws, rules and regulations, their impact on the performance of company, and identify the weaknesses of those laws. However, this thesis argued that the establishment of CSC and hiring professionals for this work will incur extra cost on companies and due to this reason companies in Pakistan may not well come this suggestion.

Therefore, this thesis provided a slightly different proposal to adjust this extra cost. This thesis argued that the establishment of a CSC will be a novel concept in Pakistan and can help in improving CG practices. However, instead of establishing CSC by every company, it can be established by the SECP and work collectively for the corporate sector of Pakistan. This CSC ought to have the capacity to measure the influence of prevailing laws and regulations on companies' performance.

CSC ought to call attention to any rigidity or adaptabilities in the laws, as well as it ought to have the capacity to recommend measures that might be contemplated by the regulators at the time of making new laws and strategies. The companies' general valuation as to the adoption of CCG ought to be made by the CSC and default with respect to a company ought to be accounted for to the regulatory authority. As this study also established that the absence of research culture in Pakistan generally is also one of the major reasons for being underdeveloped, by establishing such CSC will also promote the research culture which is necessary for the progress of every field in every State.

8.3 Contribution of this Research

This thesis contributes to the existing and developing body of literature in numerous ways and its contributions are classified into theoretical contribution and practical contribution.

8.3.1 Theoretical Contribution

This study intends to create new insights among the business community of Pakistan in terms of significance and benefits of CG principles and practices and additionally considers validating or spreading the present theoretical literature in the terrain of CG.

Firstly, this study has examined the nature of corporate sector in Pakistan and the CCG of Pakistan; and established that in spite of being mandatory in nature, CCG is not being followed truly by the listed companies. This study identified two major reasons behind partial/non adoption of CCG. One is the outdated, weak and overlapping provisions of CCG. This study has formulated recommendations which can help regulators and policy makers (SECP, PICG) while revising or updating the CCG.

Secondly, the reason identified is the weak enforcement mechanism of Pakistan consisting upon an inefficient judicial system and stock market and the reasons for these two important institutions being inefficient. This study has also formulated recommendations to reform these two institutions, as a result of which the implementation and enforcement of CG will be improved. These causes of failure of institutions in fulfilling their duties and recommendations to reform them will aid the authorities and policy makers while taking measures to enhance the capacity and efficiency of these institutions so that they could fulfil their duties in true sense and such actions will increase the adoption of CCG and the enforcement of other corporate laws as well.

Thirdly, this research has examined the role of BODs in promoting CG practices of their companies and has developed Board Effectiveness Model for the listed companies of Pakistan. This is a pioneer work as such work has not been

conducted before relating to the corporate boards of the listed companies of Pakistan. This study outlined a number of recommendations in terms of diversity in BODs particularly women on board, size, composition, independence, roles and responsibilities of BODs; which can enhance the effectiveness of BODs which will lead towards advancement of CG practices.

Finally, another important contribution of this study is related to the role of IIs explored for promoting CG practices in the listed companies of Pakistan. Such work has also not done previously regarding IIs activism and their impact on the corporate performance of their investee companies in Pakistan.

This study offers a prospect to add in the existing literature by investigating and authenticating the noteworthy aspects of CG which will help in achieving transparency, accountability, independence and disclosure in the listed companies of Pakistan which will also maximise shareholders' value in the companies of Pakistan.

8.3.2 Practical Contribution

Although this research is more strategic in nature, it also has meaningful practical contributions. This thesis conducts research which is highly important for the growth of corporate sector of a country in this globalised world where cross-border investments have become common and is crucial to regulatory bodies.

Therefore, the findings of this study can help authorities and regulatory bodies in improving corporate norms in the listed companies of Pakistan. The findings of this study can have a positive impact on the BODs and enhance their effectiveness. It can assist companies' management in reforming the structure of their boards, as this study establish that more diverse boards having a combination of skills, experience, gender-balance and fifty per cent representation of INEDs make a board more effective, efficient and independent. Such boards can take better decisions for their companies, can protect shareholders' interests in better way and usually are more inclined towards adopting CG best practices. These

findings can contribute towards achieving more independent and effective corporate boards for the listed companies of Pakistan.

Moreover, this research established the importance of IIs in contemporary corporate world and also established the wider scope for IIs in Pakistan. This study also explored the measures through which IIs can be more influential in Pakistan and can play their part in improving CG practices in the listed companies of Pakistan. These findings can be helpful for local IIs particularly in enhancing their influence in their investee companies which will also provide incentives for foreign IIs to make investments in Pakistan and use their influence to promote CG practices of their investee companies.

In short, this study has a considerable significance as it not only makes an addition in the existing academic literature of CG yet additionally provides some valuable practical contributions to this vital area.

8.4 Limitations of Research

Although this thesis has explored significant findings by successfully answering the research questions; therefore achieving the aim and objectives of this research. This study offered a strategic perspective of the CG framework of Pakistan and resulted in valuable findings adopting a qualitative approach which may have considerable impact on policy formulations as well as on future studies. Nevertheless, this research like all other research works faced some limitations which are presented below.

This research faced methodological limitations during the course of study. The methodology employed to conduct this research is more suitable and appropriate for this study; however there are some alternative methodological approaches which could have been used and were considered by the researcher; for example, case studies, interviews (both structured and semi-structured) and questionnaires. But they could not be carried out due to health issues of researcher, financial cost involved to carry out these methods and most importantly instable security situations in Pakistan (as discussed in detail in methodology chapter). Due to

these constraints, the researcher had to consider alternative approaches to conduct this research and she adopted the current methodology.

Nevertheless, the current methodology used to carry out this study is also appropriate and justified; as when methodological approaches were changed, the research questions were also changed accordingly. The findings of this study employing current methodology are more strategic in nature; which could have been more practical in nature if the alternative methodology have been employed to carry out this study.

8.5 Suggestions for Future Research

The CG is becoming a subject of its own right in this globalised world, it has many dimensions and every dimension has wider impact. This study covers only a small portion of it, and there is still a lot need to be done specifically in the context of Pakistan's corporate sector both theoretically and empirically. Therefore, the researcher is keen to continue her research journey in the form of books and/or research articles in order to explore the unattended areas of CG in Pakistan which could help in formulating new and/or to amend existing strategies for the country; as well as to enhance the exposure of general community regarding the importance of CG through her writings. Some of intended topics for future research are listed below:

- Women on corporate boards of the listed companies of Pakistan
- An investigation of corporate laws of Pakistan with a particular focus of the Companies Ordinance 1984, the Securities and Exchange Commission of Pakistan Act 1977 and the Code of Corporate Governance of Pakistan
- Why adaptation and convergence in corporate governance is necessary? Does convergence help or hinder the progress of corporate governance in Pakistan?
- Corporate governance and its effect on the performance of family and non-family companies listed on Karachi Stock Exchange
- An empirical investigation of the role and strategies of institutional investors working in the Banks of Pakistan

- Dynamics of audit quality: behavioural approach and governance framework – Pakistan's evidence

8.6 Conclusion

This study focussed on examining the CG practices in Pakistan, the relationship of CG norms with the performance of companies and exploring the measures to promote and improve CG in the listed companies of Pakistan. The results show that an effective CG framework of Pakistan depends upon various significant elements. The growth of CG norms highly depends upon the correct understanding of CG principles and their advantages among the business community of Pakistan.

Furthermore, it is very important for regulators to update CCG regularly by assessing its impact and the attitude of companies towards its full or partial adoption. The clauses of CCG should not be ambiguous as well as should not overlap with the provisions of other corporate laws. After the issuance of an effective CCG, the most important challenge is its implementation and enforcement for the regulators. As without being a law in action, there is no use of a law in books.

Moreover, it is important for companies to restructure their BODs to make them diverse in terms of experience, skills, knowledge, gender, and professionalism and independence by appointing more independent directors equivalent to executive directors and giving proper representation to women on BODs. Such corporate boards will be more independent, more accountable and more capable to manage risks and maximise shareholders' wealth.

It is also important for regulators to provide an appropriate platform for IIs where they could share problems they face while investing and working with the listed companies of Pakistan and discuss strategies collectively to influence their investee companies for the adoption of CG best practices. IIs can have a considerable impact on their investee companies due to their experience,

knowledge, investment skills and more importantly due to their large shareholdings.

As a result, the findings of this study clearly acknowledge the proclamation that CG norms meaningfully contribute towards the performance of companies; and the recommendations formulated by this thesis may help significantly to improve the CG in the listed companies of Pakistan

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